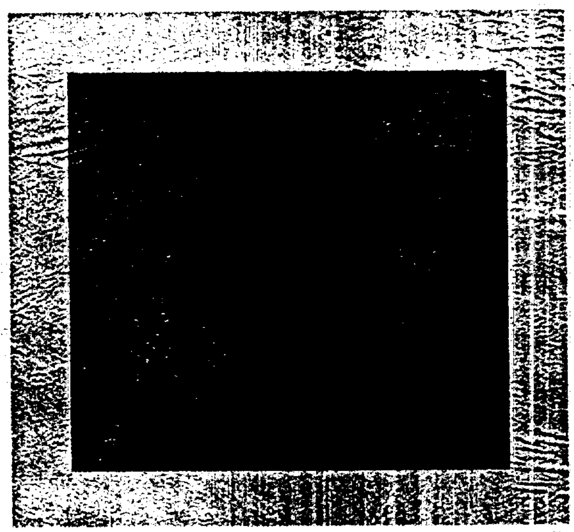
Philip Morris Companies Inc.



1989 - 1993

CONFIDENTIAL

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— William Murray - #17 —

HIGHLIGHTS

Highlights

This document is confidential. Its contents are highly sensitive and care should be taken to restrict its discussion to authorized persons.

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of various industry environments.

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PHILIP MORRIS COMPANIES INC.

PLAN HIGHLIGHTS
($ Billions except E.P.S)

	1983	1988	1993	Compound Annual Growth 1983-1988	1988-1993
REVENUES	$ 13.3	$ 31.7	$ 62.1	19%	14%
INCOME FROM OPERATIONS	$ 2.0	$ 4.7	$ 11.8	19%	20%
NET INCOME	$ 0.9	$ 2.3	$ 5.9	21%	20%
E.P.S.	$ 3.58	$10.03	$ 24.98	23%	20%
STOCKHOLDERS' EQUITY	$ 4.0	$ 7.7	$ 20.3	14%	21%
RETURN ON EQUITY	23%	32%	32%	--	--
Consumer Products					
CASH	$ 0.03	$ 0.2	$ .1	124%	(10%)
TOTAL ASSETS	$ 9.2	$ 33.8	$ 35.0	30%	1%
TOTAL DEBT	$3.1	$ 16.4	$ 4.7	40%	(22%)
DEBT/EQUITY	.76	2.14	0.23	--	--
CURRENT RATIO	1.5	1.0	1.1	--	--
RETURN ON AVERAGE ASSETS	11%	13%	18%	--	--
Consolidated					
TOTAL ASSETS	$ 9.9	$ 37.0	$ 43.2	30%	3%
TOTAL DEBT	$ 3.2	$ 17.9	$ 8.3	41%	(14%)
DEBT/EQUITY	0.79	2.34	0.41	--	--
RETURN ON AVERAGE ASSETS	10%	12%	15%	--	--

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OPERATING COMPANIES
PLAN HIGHLIGHTS
($ Millions)

OPERATING REVENUES	1983	1988	1993	Compound Annual Growth 1983-1988	Compound Annual Growth 1988-1993
PM USA	$5,520	$8,501	$14,331	9%	11%
PM INTERNATIONAL	3,647	8,086	11,200	17%	7%
KRAFT GENERAL FOODS	---	22,540	31,234	--	7%
GF USA	---	4,955	6,419	--	5%
KRAFT USA	---	4,114	5,720	--	7%
KRAFT GF INTERNATIONAL	---	4,046	5,901	--	8%
KRAFT GF CANADA	---	1,412	1,665	--	3%
OSCAR MAYER	---	2,271	3,324	--	8%
KRAFT GF FROZEN	---	2,031	3,169	--	9%
US COMMERCIAL	---	3,592	5,420	--	9%
MILLER	2,933	3,262	4,643	2%	7%
PMCC and MVRG	283	633	686	18%	2%

INCOME FROM OPERATIONS	1983	1988	1993	Compound Annual Growth 1983-1988	Compound Annual Growth 1988-1993
PM USA	$1,337	$3,087	$6,150	18%	15%
PM INTERNATIONAL	374	774	1,667	16%	17%
KRAFT GENERAL FOODS	---	1,686	3,352	--	15%
GF USA	---	322	744	--	18%
KRAFT USA	---	558	1,167	--	16%
KRAFT GF INTERNATIONAL	---	336	573	--	11%
KRAFT GF CANADA	---	167	234	--	7%
OSCAR MAYER	---	197	304	--	9%
KRAFT GF FROZEN	---	134	345	--	21%
US COMMERCIAL	---	103	291	--	23%
MILLER	224	190	377	(3%)	15%
PMCC	49	166	265	28%	10%

CAPITAL EXPENDITURES	1988	1989	1990	1991	1992	1993	Total 1989-1993
PM USA	$ 368	$ 364	$ 303	$ 267	$ 235	$ 201	$1,370
PM INTERNATIONAL	101	125	128	97	85	94	529
KRAFT GENERAL FOODS	729	833	869	842	838	918	4,300
GF USA	241	224	241	215	220	230	1,130
KRAFT USA	75	102	119	132	115	151	619
KRAFT GF INTERNATIONAL	128	180	127	135	154	171	767
KRAFT GF CANADA	31	46	49	41	44	46	226
OSCAR MAYER	112	149	160	134	118	183	744
KRAFT GF FROZEN	63	64	101	109	50	48	372
US COMMERCIAL	51	65	78	71	72	72	358
MILLER	86	93	111	103	86	49	442
CORPORATE	--	(215)	(211)	(209)	(244)	(262)	(1,141)
CONSOLIDATED	--	1,200	1,200	1,100	1,000	1,000	5,500

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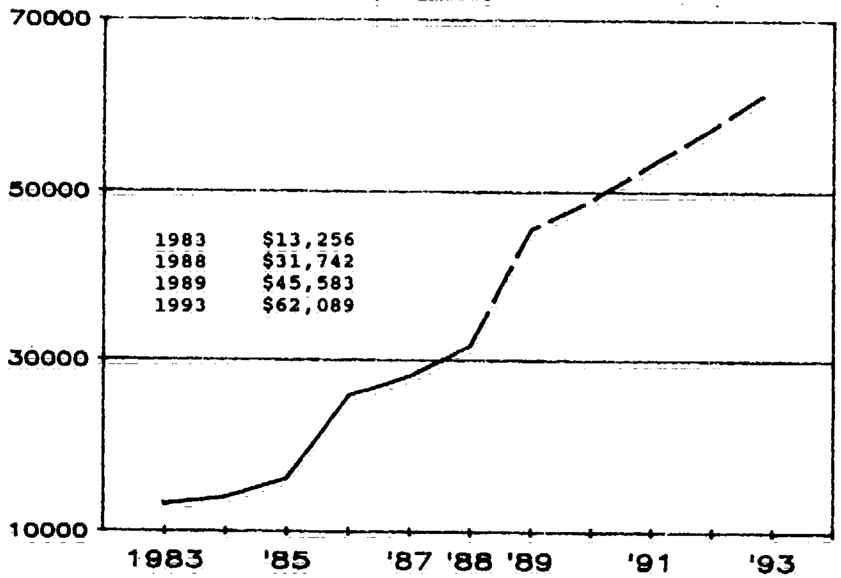
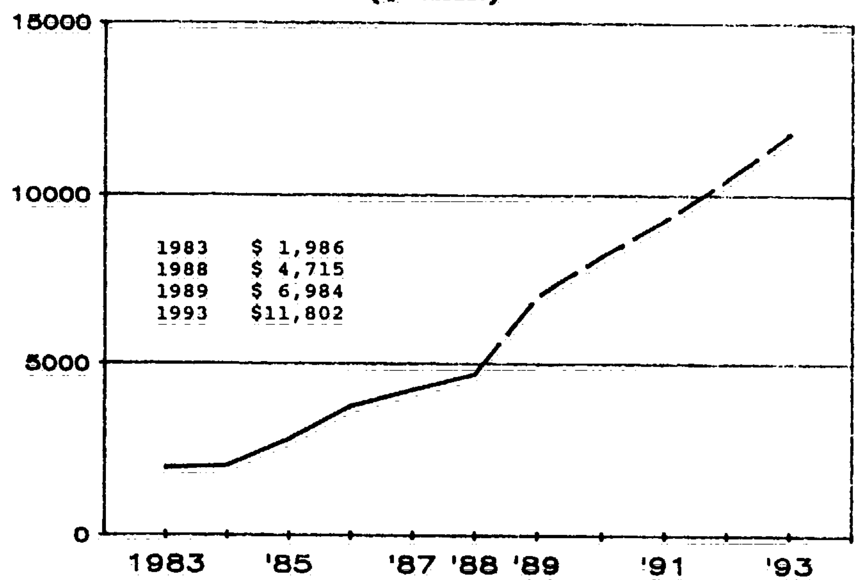
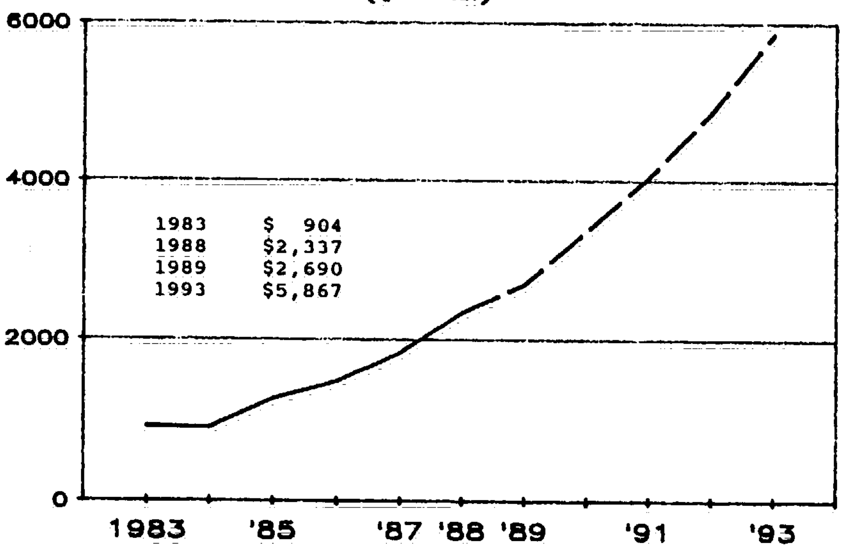
OPERATING REVENUE
($ mil.)



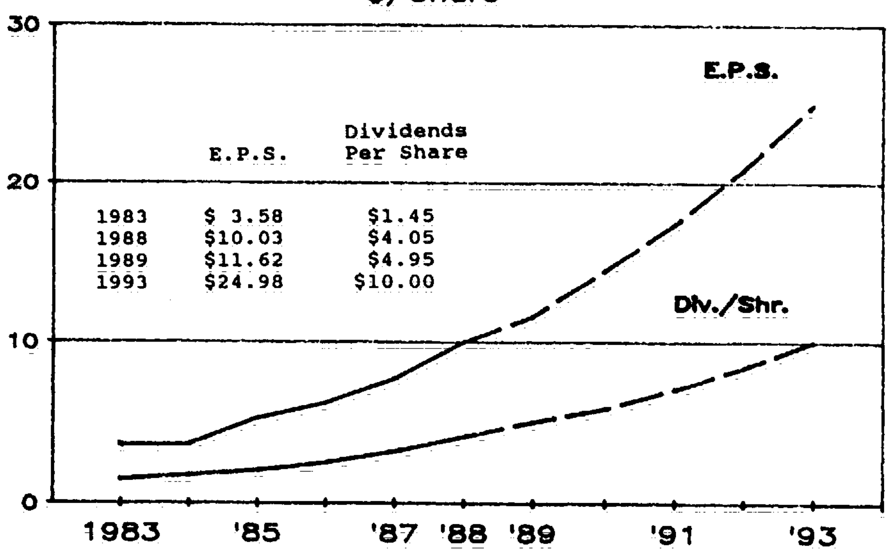
INCOME FROM OPERATIONS
($ mil.)



NET INCOME
($ mil.)



EARNINGS AND DIVIDENDS PER SHARE*
$/Share



*Adjusted for stock split 4/10/86.

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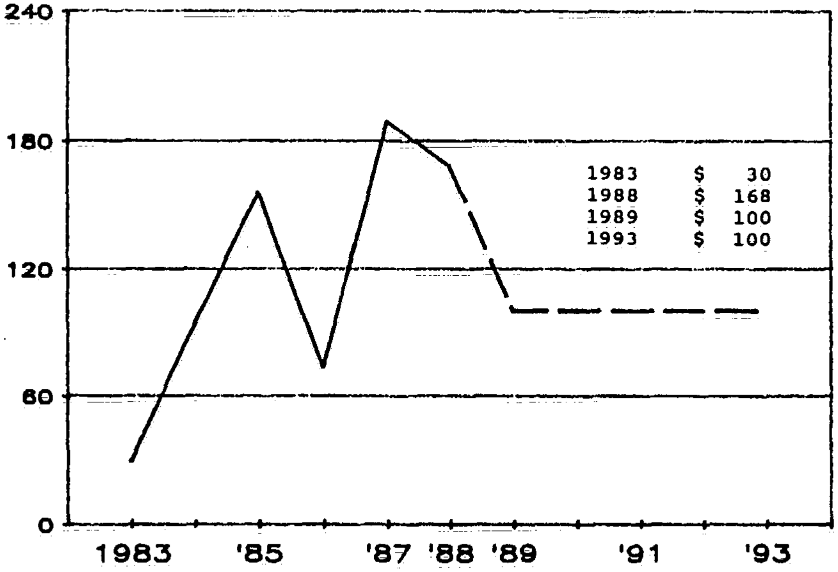
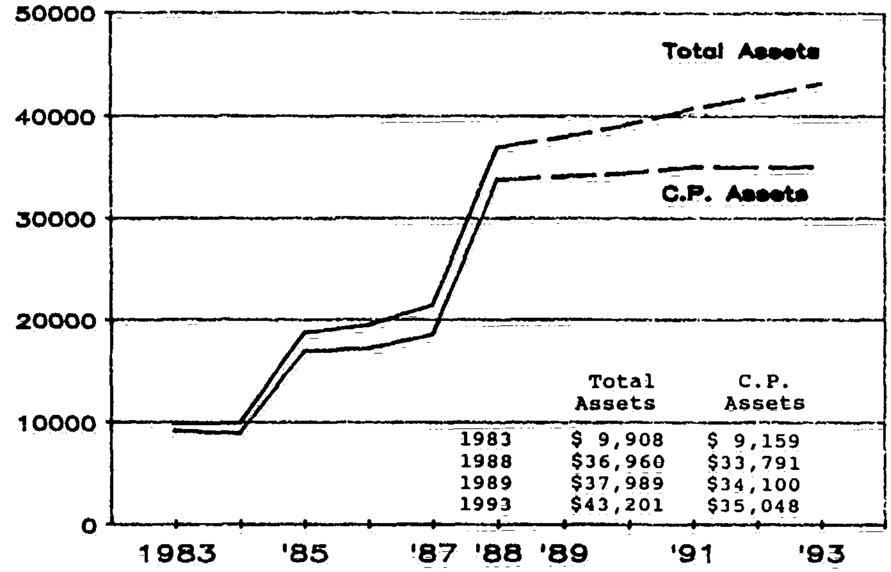
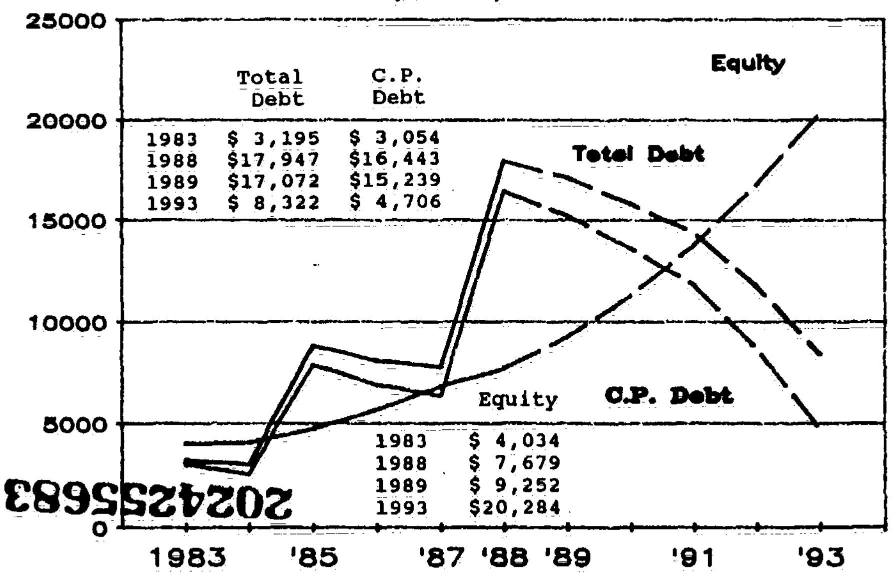
CASH & EQUIVALENTS
($ mil.)



TOTAL ASSETS
($ mil.)



TOTAL DEBT AND EQUITY
($ mil.)



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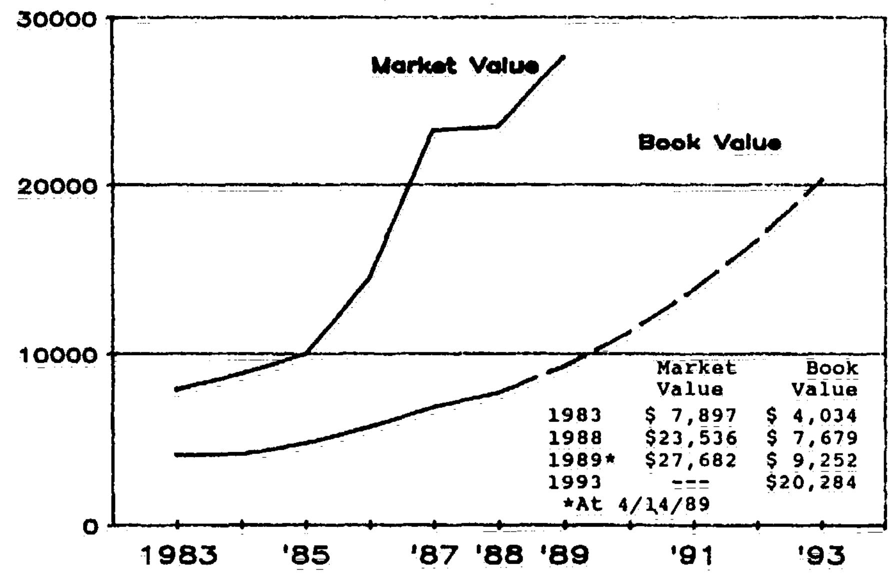
MARKET AND BOOK VALUE
($ mil.)



PLAN HIGHLIGHTS

INDUSTRY SIZE	1983	1988	Forecast 1993	Compound Annual Growth 1983-1988	Compound Annual Growth Forecast 1988-1993
DOMESTIC CIGARETTES (billion units)	596	558	479	(1.3%)	(3.0%)
INTERNATIONAL CIGARETTES (trillion units)	4.0	4.6	5.1	3.2%	2.0%
DOMESTIC FOODS (million units)*					
Coffee	132	118	108	(2.2%)	(1.8%)
Powdered Beverages	53	47	39	(2.4%)	(3.5%)
Processed Meats	2,008	2,028	1,949	.2%	(.8%)
Cereals	204	248	280	4.0%	2.5%
Viscous	1,148	1,082	1,113	(1.2%)	0.6%
Pourable Dressings	383	405	445	1.1%	1.9%
Cheese	2,915	3,117	3,314	1.3%	1.2%
DOMESTIC BEER (million barrels)	184	187	188	0.4%	0.1%

UNIT VOLUME	1983	1988	Forecast 1993	Compound Annual Growth 1983-1988	Compound Annual Growth Forecast 1988-1993
PM USA** (billion units)	205	222	238	1.6%	1.4%
PM INTERNATIONAL (billion units)	245	335	408	6.5%	4.0%
KRAFT GENERAL FOODS (Domestic) (million units)*					
Coffee	55	42	46	(5.3%)	1.7%
Powdered Beverages	40	40	34	(.2%)	(3.3%)
Processed Meats	372	446	494	3.7%	2.1%
Cereals	35	33	38	(0.9%)	2.9%
Viscous	581	551	581	(1.1%)	1.1%
Pourable Dressings	169	194	233	2.7%	3.8%
Cheese	974	1,107	1,255	2.6%	2.5%
MILLER (Domestic Beer) (million barrels)	38	40	48	1.5%	3.7%

MARKET SHARES	1983	1988	Forecast 1993
PM USA	34.3%	39.3%	49.0%
PM INTERNATIONAL	6.2%	7.2%	8.0%
KRAFT GENERAL FOODS			
Coffee	38.9%	34.0%	40.6%
Powdered Beverages	69.8%	80.9%	81.0%
Processed Meats	18.5%	22.0%	25.3%
Cereals	15.5%	12.5%	13.2%
Viscous	50.6%	50.9%	52.2%
Pourable Dressings	44.2%	47.8%	52.3%
Cheese	33.4%	35.5%	37.9%
MILLER	20.4%	21.6%	25.7%

* Food units are: Coffee - 12 lbs. ground or 48 oz. soluble; powdered beverages - 24 gallons mixed; processed meats - lbs.; cereal - 10 lbs; and viscous, dressings and cheese - lbs.

** 1983 has not been restated to post spin-off format and does not include overseas military units. 1988 and 1993 include overseas military sales of 2.4 billion and 2.6 billion respectively.

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CORPORATE
OBJECTIVES

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Corporate Objectives

PHILIP MORRIS COMPANIES INC.

Corporate Objectives

The following set of objectives is a framework to guide the corporation and the individual operating units. We believe the objectives have both corporate and specific applicability: the same standards which we use to evaluate overall corporate performance, we also use to assess the performance of the component units. In the context of the plan we will examine and review our progress in meeting earlier objectives, determine the continued validity of these objectives, and set new goals or modify existing ones. Where continuing objectives have not been met fully, we will plan actions to satisfy them. Overall, we believe the objectives established in prior plans continue to serve as attainable targets and also ensure superior corporate performance. We, therefore, have the following objectives this plan period.

Financial Objectives

- To have the corporation and each of its businesses continue to grow in unit volume, market share and profitability.
- To maintain a rate of earnings per share growth which exceeds inflation by at least 10% and which compares favorably with the performance of major competitors.
- To maintain, over time, a superior corporate return on equity and to improve the return on investment and assets of each business unit and operating company.

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- To improve the value of our stockholders' investment and to take actions such that the corporation's market capitalization fully reflects its superior performance and earnings power.

We do not consider that our involvement in mature industries prevents our growth in unit volume, market share, and profitability. Our high existing market share in some mature categories makes volume growth difficult but many of our businesses have substantial room for volume growth in the United States as well as internationally. In certain industries, pricing flexibility and low levels of further new investment may result in satisfactory profitability even if there is no progress in unit volume or in market share. Despite these challenges, it is our goal to give priority to profitable unit volume growth. In most product lines, this has been accomplished. We expect to continue improving our volume results through line extensions, geographic expansion, and innovation into new categories.

Our financial objectives encompass an annual growth target of earnings per share of at least 10% in excess of inflation. Such growth is in line with our historic trends, and forms one of the bases for the stock market support for our shares. This plan projects a growth rate which is substantially higher than this stated objective. Further, this plan does not benefit from changes in the federal income tax as did the preceding two plans. At the same time, we recognize that overall earnings improvement should largely be driven by improved income from operations reflecting better business performance. It is our long-term, albeit ambitious, goal to have total corporate income from operations also grow at 10% in excess of inflation: a goal which is reached in this plan period with the absence

of Kraft in the 1988 base year. It would also be reached if Kraft were included on a pro forma basis from 1988. In setting such a composite target, we take into consideration the intrinsic growth possibilities of the varying businesses in which we participate. In short, we seek to have growth in returns to our shareholders primarily reflect the growth of the business results.

We intend to continue improving the returns both for the Corporation and for each of the operating units over time. The high level of investment in new products and technologies may result in fluctuation in the pattern of returns in some categories. However, this investment reflects other corporate objectives of product quality, productivity and capacity. Over time, we expect all return measures to improve.

Increasing shareholders' value remains an objective of paramount importance for the corporation. Shareholder value during the past year has been enhanced by earnings increments, dividend increases and the share repurchase program. In recent months we have seen some evidence of a price/earnings multiple improvement in our stock price together with a narrowing of our discount to the S&P 500. The acquisition of Kraft, and the resultant change in our business mix, has undoubtedly contributed to this improvement. The KK&R valuation for RJR Nabisco and a lessening of investor concerns about tobacco product liability have probably contributed to this improvement as well. A meaningful improvement in the results of our food and beverage businesses would likely be rewarded by the market disproportionate to the incremental income. Nevertheless, we still believe the market has not fully rewarded our overall financial strength. We will enhance our attempts to improve our market value through judicious use of

the company's cash flow. We will also maintain our efforts to explore all available financial options including dividends and share repurchases to increase the return to our shareholders.

Product, Facilities, and Capacity Objectives

- To insure that all our products are measurably superior in quality and perceived value to those with which they compete.
- To continue to invest in modern manufacturing, distribution and research and development facilities which assure low-cost supplier status in our industries, leading to increased profits over time.

We believe that superior product value and quality creates and sustains the loyalty and continued confidence of the consumer. To that end, we must continuously strive to improve the contents, process, packaging, and presentation of our products. In certain areas we need to correct some erosion of consumer appeal. Consumer health and nutrition concerns about fat and cholesterol mean fat replacement and lower cholesterol products become an integral part of Kraft's future growth for most product lines as well as for certain General Foods products. Coffee quality has been improved by the new natural decaffeination process, better quality blends and improved packaging. Cereal will improve product quality to the consumer with the completion of the new material handling center and carton consolidation. Certain flavors in pourable dressings require reformulation to achieve superiority to competition. Tobacco must continue research and development efforts for new products and for technological innovations attractive to the consumer.

We intend to continue to invest in food industry manufacturing and distribution facilities, while fully supporting and investing in tobacco and beer new product technology. Additional food facilities are planned for processed cheese, turkey capacity, and meals production facilities. Overall, our past investments for tobacco and beer operations have led to modern facilities supporting our unit volume growth projections over the plan period. Factory modernization, high speed tobacco machinery, and draft beer lines are planned, but no new plants are projected. The results of these earlier investments is that Philip Morris continues to be the low cost producer in tobacco and suffers no cost disadvantages in beer.

Other cost reduction efforts intended to enhance our competitive position include the recent restructuring of General Foods coffee, international, and domestic grocery businesses. At Kraft, its Productivity Program has resulted in substantial cost savings across all areas which are captured and retained for the bottom line. We intend to introduce, throughout the company, measurable and quantifiable productivity programs in which cost savings are captured and retained. The consolidation of Kraft and General Foods into one group will also result in improved costs and efficiencies in distribution, sales and marketing. With the formation of the Kraft General Foods Group, our challenge is to mold these two excellent organizations into the best food company in the world.

— <u>Corporate Resource Opportunities Objectives</u>

- To maximize the benefits possible from our growing manufacturing, distribution and marketing resources.
- To create added value from combining corporate resources.

Philip Morris is now the world's largest consumer goods company and possesses a wealth of manufacturing, distribution, marketing, engineering and research and development skills. Our products have a major presence at retail and with consumers. Beyond the formation and integration of the Kraft General Foods Group, it is desirable, where appropriate, to maximize our resources for the mutual benefit of the operating companies while not compromising the philosophy underlying our overall structure with distinct operating companies. We will benefit from various joint manufacturing, distribution, promotion and sales synergies over the plan period. In addition to implementing these cost saving opportunities, we are increasingly using the Credit Corporation activities to support other business segments. Examples of this include our investments with Louis Rich turkey farmers, Miller Brewing distributors, and investments in retailers such as Southland and Kroger.

<u>Acquisitions, Divestitures and Growth Objectives</u>

- To increase, over time, the contribution from food and beverage consumer products to corporate revenues and income while supporting growth and development of our worldwide tobacco business.
- To consider and implement acquisitions complementary to our existing businesses, and implement divestitures of businesses that do not fit with our long-term goals.
- To constantly review investing in those growth opportunities which are compatible with our existing businesses.

We accomplished a major step in 1988 toward the first objective with the acquisition of Kraft Inc. This acquisition expands the food, beverage.

and finance areas to 62% of revenues and 35% of income from operations in 1989. The business segments grow at comparable rates from 1989 through 1993. Thus, the food, beverage and finance contribution to income is still 34% in 1993. While we hope to achieve a higher proportion of income for food and beverages over time, we will not do this at the expense of our tobacco business. We may be able to grow our food and beverage businesses somewhat faster then now planned, but it is unrealistic to expect a major alteration in the current mix of income from our existing portfolio. Therefore, in the absence of a significant shortfall in tobacco earnings which would change the distribution of income, any significant shift would require a series of acquisitions or a major acquisition, as well as continued internal growth and development. The mix will also change as we focus on the divestiture of certain businesses which do not fit with our long-term strategic goals. Our emphasis in the short-term will be to integrate and manage well our existing businesses in conjunction with our assessment that we wish to continue participation in those businesses. Non-strategic assets which do not contribute to our business performance should be divested.

In the short-term, we would only be interested in complementary acquisitions of a manageable and attractive scale, financially and otherwise which add to our growth prospects. In the intermediate term, we remain interested in acquisitions to strengthen and expand our businesses. Over time, we believe it appropriate to make acquisitions and shall continue to review those aimed at strengthening, broadening, and expanding geographically our existing businesses.

Environmental Objectives

- To foster a working environment through compensation and other policies in which creativity and initiative are rewarded, bureaucratic procedures are subdued and sensible risk-taking is encouraged.
- To develop new programs and initiatives which will diminish controversy and improve public perception related to our products.
- To be an exemplary corporate citizen and employer where we operate, and to continue activities and programs which enhance our reputation with the public and with our employees.

These objectives are the same as in last year's plan. The specific programs to satisfy these objectives may vary somewhat. We believe that our compensation is competitive, corresponds to those industries with which we compete and is closely related to goals and actual performance of the operating companies and business units. We have initiated several employee special award programs intended to reward creativity and performance. We are examining the possibility of an ESOP as a corporate-wide employee benefit. Philip Morris Companies Inc., as a holding company, operates with a limited staff and encourages a high degree of delegation to the operating units. The restructuring programs at General Foods, initiated at the end of 1988, and the formation of Kraft General Foods Group into seven new operating units, are examples of our efforts to consolidate parallel functions and systems, to minimize administrative layers of management and encourage quick response to our customers.

It is imperative that the company continue to develop programs and take initiatives to improve the public perception related to some of our products. We will make all appropriate efforts to mitigate the impact of any controversy surrounding tobacco and alcoholic beverage products. With respect to food and other products, we will take all steps necessary to alleviate perceived nutrition, health and packaging safety concerns and take competitive advantage of the assurances provided by our branded consumer products.

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Summary of Plan

Summary of the Plan

This plan projects increasing unit volume, market shares, operating revenues and net earnings in a broad range of consumer products as a means to increase shareholder value, and maintain a dynamic and forward looking organization. It also emphasizes the continued utilization of our financial resources including excess cash flow and borrowing capacity.

This plan continues to view Philip Morris as a growth oriented consumer products company over the next five years. The acquisition of Kraft, completed on December 7, 1988, demonstrably changed our product, revenue, and income mix. With the addition of Kraft, we are now the largest consumer packaged goods company in the world and aspire to become the best. The newly formed Kraft General Foods Group constitutes the second largest food business in the world. We believe we now have a solid base of branded products with strong positions in a number of large and profitable consumer products categories. Over time, this base will be expanded, deepened, and pruned to create a better foundation of branded consumer products. Even if a number of the industries or segments in which we participate are mature, we believe Philip Morris is in a position to increase its market share and profitability by leveraging our strong franchises. At the same time, we continue to see volume and income growth opportunities in many of our less mature industries.

Our tobacco businesses continued to grow in 1988 in volume, share, and income. During 1988, Philip Morris' worldwide cigarette volume clearly surpassed that of British-American Tobacco. Food, beverage and financial services contribution to income is forecast to be 35% in 1989. Income from food, beverage and finance operations grows and represents 34% of income in 1993. We intend, over time, to make food and beverage income a higher

ratio than forecasted in this plan. We believe that this objective can be accomplished through prudent use of our financial resources while fully supporting our tobacco businesses.

Effective March 1, 1989, we announced the formation of Kraft General Foods Group with seven operating units. We believe this integration will provide the organization with a more streamlined and profitable food group. General and Administrative savings expected as a result of the formation of the Kraft General Foods Group are included in the financial statements.

During 1988, the Company's results were generally in line or ahead of the 1988 Five-Year Plan. This is true even with the interest expense and the resultant earnings dilution from the Kraft acquisition. Actual 1988 net earnings were $2.337 billion, slightly higher than the 1988-1992 plan projection of $2.290 billion. We incurred a charge of $348 million to income from operations in the restructuring of certain General Foods units. The restructuring charge was fully offset on an annual basis in net earnings by the adoption of FAS 96. Despite the restructuring charge, income from operations in 1988 reached $4.715 billion, an 11% increase over 1987, compared with the previous plan projection of $4.810 billion. During 1988, stockholders' equity increased to $7.679 billion, close to the prior plan of $7.747 billion. This equity level was reached despite the completion of the $12.9 billion Kraft acquisition in December 1988 and share repurchases throughout the year. We have been able to reduce our debt and repurchase shares, while still increasing dividends. The market has rewarded our performance with an increase in our stock price and a moderate increase in our price/earnings ratio, but we expect to do better.

There is a corporate adjustment in this plan, beginning at $400 million in 1990 and increasing annually to $550 million in 1993. This

adjustment is taken to account for the possibility of an industry decline in U.S.A. cigarette consumption greater than that forecast and other negative contingencies. The plan incorporates no changes in the Federal Excise Tax structure for tobacco or beer over the plan period. The impact of state excise tax increases is incorporated in the plan. Further, no changes in the Federal Income Tax structure are incorporated. The corporate adjustment would also compensate for some dilution as a result of acquisitions over the plan period.

The consolidated financial statements include the cash generated by all operating companies without specifically allocating it for new business investments unless such investments have already been approved. Conversely, no business divestitures are incorporated into the plan numbers. Various divestitures and acquisitions are a likely occurrence in the plan period and are an obvious source and use of cash, but they are not reflected in the financial statements. Disposal of those businesses which no longer fit with our strategic objectives will be implemented if appropriate value can be received.

The plan assumes that, in general, the macroeconomic environment will remain relatively stable and favorable. Inflation is expected to remain moderate at approximately 5%, while disposable income per capita is projected to grow at a slightly higher rate. Any changes in the value of the dollar could have an impact on the income of both Philip Morris International and Kraft General Foods International.

Our plan is to grow operating revenues at a 14.4% compound annual rate to $62.1 billion in 1993. At the same time, our income from operations and net income will grow at compound annual rates of 20.1% and 20.2% to $11.801 billion and $5.867 billion, respectively. This accelerated income growth

from past plans stems primarily from the acquisition and full inclusion of Kraft.

We forecast maintaining our current high level of return on equity moving from 32.2% in 1988, to 32.7% by 1990, and then, as leverage is reduced, to 31.7% in 1993. By 1993, we will improve our return on assets to 17.7% and our return on investment to 25.4%.

The major strategic issues facing the corporation continue to be, in large part, similar to the ones we faced last year:

- improve shareholder value;
- develop the organization to manage effectively a large group of consumer products;
- exploit corporate-wide opportunities to utilize joint areas of expertise for the mutual benefit of the operating companies;
- anticipate and respond to environmental issues of government intervention, health and nutrition, and international trade; and
- achieve over time more income from food and beverages by demonstrated internal growth and complementary acquisitions, combined with appropriate divestitures.

These issues are discussed in more detail in the Key Issues section.

Improving shareholder value is perhaps even more important in the current environment than previous plans. To achieve this goal, our existing businesses need to grow and we must effectively utilize our free cash. Our projected excess cash, in addition to any available borrowing capacity, will be used initially to support, enhance and complement our existing businesses both domestically and internationally. We intend to continue to make complementary acquisitions to improve, deepen, and expand our existing businesses.

Furthermore, we intend to continue to review our cash balances and borrowing capacity in the context of investing in external acquisitions, increasing dividends, repurchasing shares, or a combination of these. We will continue to review our existing assets to insure that appropriate returns are being achieved, and to consider and implement disposal where we conclude that satisfactory returns will not be forthcoming.

The stock market has undervalued our stock relative to the overall market, particularly in view of our consistently increasing earnings and strong cash generation. Over the plan period, the tobacco business remains the principal source of earnings. Further, the contribution of tobacco to income throughout the plan period is almost constant. Even without tobacco product liability concerns, it is likely that we would trade at a discount to the overall market due to declining U.S. cigarette industry consumption.

We intend to continue to support the cigarette business with all appropriate resources and are committed to its future success. We believe that tobacco still represents major opportunities for profitable growth and market share increases both domestically and internationally. Despite the lower price/earnings multiple generally afforded tobacco earnings, expansion of this business represents a good investment for the shareholders.

In the tobacco business, many profitable markets, including the U.S., are in countries where industry volume is flat or declining. Therefore, increased profitability in these businesses will continue to be primarily dependent on market share increases as well as price increases. Due to industry declines and resulting overcapacity, flexibility of pricing for tobacco in this plan period and beyond may moderate as an element for increasing profits. This makes unit volume growth even more important than

previously. Market share increases are also necessary with respect to the U.S. beer and coffee markets in order to achieve the plan objectives. Volume growth for other food categories, such as pourable dressings and viscous products, depends as well on market share increases. Certain segments of the food industry, such as cheese and cereals, have evidenced overall growth and the plan reflect continued industry growth.

We intend to continue to diversify our earnings base and to increase the percentage of our revenue and income from food and beverage operations. Kraft was obviously a very meaningful step toward this goal. Our food and beverage businesses will grow income somewhat faster than shown in this plan as a result of synergies, accelerated internal development, and acquisitions.

Another issue is management structure of this organization to achieve effective utilization of our large size. We recognize that we are the largest consumer products company in the world. At the same time, decision making should be decentralized and management structured to enable the operating companies to exploit opportunities in our respective businesses. Large size provides the diversified financial base to take advantage of these opportunities and the management structure should enable us to utilize those advantages on a timely basis.

Important advantages to be gained from large size include jointly leveraging our expertise in research, engineering, manufacturing, distribution, sales and marketing. Each operating entity in the organizational structure will remain responsible for its own businesses. However, it makes sense to utilize the wealth of talent throughout the corporation to the mutual benefit of all.

There are issues and challenges facing each of the operating companies. These are dealt with in the operating company plans. Selected highlights from the operating company plans follow.

Philip Morris U.S.A

Industry	1983	1988	1989	1993	CAG 1988-1993
Volume (billions)	596	558	540	480	(3.0%)
Division					
Volume (billions)	205	222	223	238	1.4%
Market Share	34.3%	39.3%	41.1%	49.0%	--
Financial Summary ($ Mil)					
Operating Revenue	$5,520	$8,501	$9,544	$14,331	11.0%
Income from Operations	$1,337	$3,087	$3,706	$ 6,150	14.8%
% of Sales	24.2%	36.3%	38.8%	42.9%	--
Capital Expenditures	$ 227	$ 366	$ 360	$ 200	
Funds Generated from Operations	$ 942	$2,475	$1,826	$ 4,068	--
Return on Assets	26.4%	71.5%	79.6%	114.9%	--

Industry

- The industry is projected to decline 3.0% per annum for a total industry decline of 78 billion units through 1993. Total industry volume is expected to be 480 billion units in 1993.
- The price/value segment will increase to 25.2% of the market by 1993. A third lower priced tier below the current price/value segment is projected.
- No changes in the Federal Excise Tax structure are incorporated.
- State Excise Tax increases will exceed inflation.

Competition

- All companies except PM USA are projected to continue current negative share and volume trends.
- PM USA volume objectives require an increase of 9.7 share points over the five-year period.

Objectives and Strategies

- Continue volume and share gains for MARLBORO.
- Strengthen brand images.
- Improve retail availability and visibility.
- Continue volume expansion in price/value category.
- Feature technological innovation in new products.
- Maintain cost efficiencies and reduce overhead.
- Meet volume requirements with existing facilities.
- Increase prices in excess of inflation.
- Moderate industry decline through Corporate Affairs.

Financial

Operating income growth driven by volume increases, price increases, and manufacturing efficiencies.

PHILIP MORRIS INTERNATIONAL

	1983	1988	1989	1993	CAG 1988-1993
Industry (trillions)	4.0	4.6	4.7	5.1	2.0%
Volume (billions)	245	335	348	408	4.0%
Financial Summary ($ million)					
Operating Revenue	$3,647	$8,086	$8,002	$11,200	6.7%
Income From Operations	$ 375	$ 775	$1,029	$ 1,665	16.6%
% of Sales	10.3%	9.6%	12.9%	14.9%	
Capital Expenditures	$ 42	$ 99	$ 125	--	--
Funds Generated From Operations	$ 226	$1,411	$ 500	--	
Return on Assets	8.0%	11.5%	18.5%	23.6%	--

Industry

- Current industry volume is 4.6 trillion units and grows to 5.1 trillion outside the United States (PM share 7.3% in 1988, rising to 8% by 1993).
- No new major market openings are foreseen in plan period; Indonesia and Thailand represent medium-term opportunities; China and USSR present longer term opportunities.
- During 1988 we gained share in 18 of our top 20 markets.

Objectives

- CAG rates of 4.0% in volume and 16.6% in income from operations.
- Prepare for Europe in 1992.

Strategies

The following five markets will account for 56% of PMI's income from operations in 1991:

Japan (7.9% CAG unit volume growth to 29.0 billion, 36.5% CAG income growth to $194 million)

- Investment spending in marketing to build our business.
- Maximize use of creative TV advertising for Lark and other international brands.
- Expand promotional activities to widen PM distribution.
- Generate incremental volume with new brands and line extensions.
- Expand sales force, prepare for media ban, develop Key Accounts, and grow vending.

West Germany (6.2% CAG unit volume growth to 38.2 billion, 15.9% CAG income growth to $282.1 million)

- Increase profitability through volume and share growth.
- Limit price increases to preserve industry volume.
- Achieve rapid growth in the lights segment.

France (7.3% CAG unit volume growth to 25.0 billion, 50.0% CAG income growth to $86.0 million)

- Achieve average manufacturers selling price increases of 9.5% and bring pricing closer to balance of EEC.
- Increase our share of advertising quota to our share level.
- Lobby government for price increases.

Turkey (6.3% CAG unit volume growth to 12.2 billion, 19.6% CAG income growth to $108.3 million)

- Prepare for transition to local manufacture.
- Negotiate successfully a joint venture.
- Maintain Marlboro leadership in the imported segment.
- Secure the major share of the emerging lights segment.

Italy (2.9% CAG unit volume growth to 36.5 billion, 7.4% CAG income growth to $194.3 million)

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- Achieve volume gains by increasing our share of the foreign segment, while maintaining our relationship with Monital.
- Use the licensee production levels to lessen impact of Monital's declining volume and to avoid an increase in the price gap between MS and our brands.

The following four markets have held back our volume and earnings growth:

United Kingdom - Flat share (5%), losses ($25m), and no signs of a turnaround have led to examination of restructuring alternatives including the pending joint venture.

Brazil - Inflation (900%), low margins, declining volume (9%), and operating losses ($9m) have left us with the option of a merger, sale, or shut down of operations.

Saudi Arabia - Duty increases and a weak economy have led to downtrading. Absorption of anticipated customs duty increase should result in higher volume but declining income,

Korea - Greater consumer focus, corporate affairs actions, and decreased distribution costs should reduce losses due to a less than optimum mix of products and discrimination against foreign manufacturers.

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Kraft General Foods Group

	1988 (Pro forma)	1989	1993	CAG 1988-1993
Financial Summary ($ Mil)				
Operating Revenues	$22,540	$23,972	$31,234	6.7%
Income from Operations	$1,686	$2,171	$3,352	14.7%
% of Sales	7.5%	9.1%	10.7%	--
Capital Expenditures	$729	$833	$918	--
Funds Generated from Operations	$1,160	$1,777	$2,668	--
Return on Assets	10.5%*	12.2%	15.3%	--

*Based on pro-forma financials and excludes the 1988 restructuring.

Kraft General Foods' Working Mission is to become the leading food company in the world, based upon achieving superiority versus competition on a balance of the following factors:

- Outstanding overall quality in all aspects of operations.
- Return on Management Investment.
- Rate of real growth in Unit Sales and Operating Income
- Productivity.
- Innovation.

The financial objectives are to put KGF in the top quartile of Food Industry performance for:

- Operating revenue growth.
- Income from operations growth.
- Income from operations margin.
- Return on assets.

Strategies

- Focus resources on countries, categories, and brand franchises with significant profit and return potential where KGF can develop a sustainable competitive advantage.

- Categorize and manage new business development activities to avoid undue risk.
- Identify and leverage all possible synergies among KGF units.
- Pursue optimum asset and expense productivity in all business units on a continuing basis.
- Manage all aspects of KGF business with a global perspective.
- Be organizationally flexible.

General Foods U.S.A.

	1988	1989	1993	CAG 1988-1993
Volume (million weighted units)	281	280	303	1.5%
Financial Summary ($ Mil)				
Operating Revenues	$4,955	$5,135	$6,419	5.3%
Income from Operations	$324	$425	$744	18.2%
% of Sales	6.5%	8.3%	11.6%	--
Capital Expenditures	$241	$224	$230	--
Funds Generated from Operations	$340	$338	$624	--
Return on Assets		9.9%	15.8%	--

Industry

- Industry volume growth will be less than 1%, i.e., in line with population trends, although it will vary by category.
- Continued consumer emphasis on health, nutrition and convenience will continue.
- Retail trade will consolidate and become stronger.
- The total U.S. coffee market is expected to decline at a 1.8% CAG.
- The U.S. soluble coffee segment will decline at a faster rate of 6.4%.
- The International Coffee Organization agreement will likely lapse and green bean prices will decline in late 1989 and 1990 and thereafter rise moderately.

Objectives

- Grow share, volume and income in the established grocery businesses.
- Earn a competitive return on assets.
- Focus development efforts on close-in opportunities and commercialize key growth opportunities.

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- Realign portfolio to be more in line with consumer trends.
- Divest declining businesses with limited strategic value.
- Add new business for growth potential through the 1990's.
- Broaden availability of products by expanding distribution to new channels and geographies.
- Build Maxwell House Co. share of U.S. market to over 40% by growth of the base business, new product and packaging introductions, and line extensions.
- Achieve Maxwell House brand leadership in the U.S.
- Build Maxwell House Co. margins to 6.5% via improved product mix and cost reductions.
- Grow U.S. Foodservice beverage business and manage costs.

Strategies

Baked Goods

- Volume growth of 1.4% CAG and income growth at 10.6% CAG to $121 million.
- Launch successfully cholesterol-free products
- Manage aggressively fixed and variable costs, and improve productivity.

Cereals

- Volume growth of 2.9% CAG raises market share to 13.2% and income to $145 million (a 16.7% CAG) by 1993.
- Improve advertising execution of established brands, develop successful new products, and implement proper marketing and sales execution required to achieve these goals.

Desserts

- Packaged desserts income will reach $157 million in 1993 (a 3.4% CAG), through share and price increases in a declining market.
- Ready-to-eat refrigerated desserts will become profitable and generate income of $41 million in 1993.

Beverages

- In the declining Powdered Soft Drink category (3.3%), income will increase at a 5.3% CAG to $154 million in 1993 as share is maintained.
- Ready-to-Drink beverages will make $7.7 million in income by 1993 as the market matures, costs are managed, and new trademarks introduced.

Shelf Stable Foods (achieve revenues of $228 million in 1993 with an income of $14.6 million)

- Opportunities in multiple segments.
- Achieve production cost targets at appropriate volume levels.
- Leverage existing trademarks.
- Use phased approach to capital investment and market introduction.
- Explore external development options.

Maxwell House (grow volume 1.6% CAG, income of $100 million in 1993)

- Develop and launch new value added products over the plan period.
- Fill segments underrepresented by existing product lines.
- Improve share using product quality, packaging initiatives and development of new products.

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Kraft U.S.A.

	1988	1989	1993	CAG 1988-1993
Division				
Volume (million lbs)	2,940	2,858	3,279	2.3%
Financial Summary ($ Mil)				
Operating Revenue	$4,114	$4,396	$5,720	6.8%
Income from Operations	$558	$793	$1,167	15.9%
% of Sales	13.6%	18.1%	20.4%	--
Capital Expenditures	$ 75	$102	$151	--
Funds Generated from Operations	$491	$470	$735	--
Return on Assets		39.3%	43.2%	

Industry

- Domestic cheese consumption will increase 1.2% CAG with an increasing trend toward low-fat and low-cholesterol cheese.
- Specialty cheese segment will grow share.
- The grocery industry will remain flat with limited growth opportunities.
- Fat replacement and low cholesterol extensions will increase share in both Refrigerated and Grocery categories.

Objectives

- Operations will provide competitively advantaged products and services to operating units and customers. Develop, produce and deliver products for lowest cost at desired quality and service levels.
- The sales organization's goal is to become the standard of quality in the industry by leveraging Kraft resources, developing people, and focusing the organization against measurable activities.

Refrigerated

	1988	1989	1993	CAGR 1988-1993
Tonnage	1,112	1,121	1,369	4.3%
Net Sales	$2,073	$2,247	$2,978	7.5%
Operating Income	$ 278	$ 401	$ 580	15.8%

- Deliver tonnage and profit growth in main cheese businesses while investing in meaningful new products with differentiation and technological leadership.
- Maintain trade spending at current levels and focus on the consumer.
- Lead the consumer trends of health and convenience.
- Improve productivity at all levels.
- Develop Chilled Foods into a profitable business.
- Deliver profits through price realization, low commodity costs and productivity.

Grocery

Tonnage (MM Lbs.) 1988	1993	Brands/Categories	Operating Income (MM$) 1988	1993
378	396	Miracle Whip	$126	$185
150	159	Mayonnaise	23	40
24	26	New Viscous	5	9
158	183	Kraft Pourables	65	97
36	50	Seven Seas	5	8
159	161	Barbecue Sacue	18	34
397	400	Tablespreads	(10)	22
59	53	Fruit Spreads	0	1
70	77	Marshmallows	7	14
18	15	Confections	4	5
249	239	Traditional Dinners	81	98
--	31	Versatile Side Dishes	--	11
--	33	Shelf Stable Microwave Meals	--	6
--	59	Fat Replacement	--	5
15	14	All Other	(15)	2
1,713	1,896	Total*	$260	$471

*Total includes Food Service Penalty and Contingency Funds

- Accelerate profit growth by aggressive but prudent pricing, cost control, improved forecasting and contingency planning.
- Revitalize the core franchises using product superiority, focused new products and consumer oriented spending.
- Turnaround share and volume trends in mayonnaise, pourables, and tablespreads.
- Create new growth initiatives with Versatile Side Dishes, Shelf-Stable Microwavable meals, and identify new growth areas.
- Build competitive advantage by technological superiority, fat replacement, and pan-category initiatives.

Kraft General Foods International

	1988	1989	1993	CAG 1988-1993
Division				
Volume	1,303	1,378	1,588	4.0%
Financial Summary ($ Mil)				
Operating Revenue	$4,046	$4,400	$5,901	7.8%
Income from Operations	$ 336	$ 385	$ 573	11.3%
% of Sales	8.3%	8.8%	9.7%	
Capital Expenditures	$ 128	$ 180	$ 171	
Funds Generated from Operations	$ 370	$ 160	$ 424	
Return on Assets		12.0%	13.7%	

Industry

- International coffee volume will grow at a .8% CAG.
- Key issues in Europe are 1992, strength of retail trade, and acquisition climate.
- In Asia-Pacific, new markets remain to be tapped.

Objectives

- Grow selectively in advantaged markets.
- Develop world class management.
- Maximize potential of core businesses while defending against competitive attacks.
- Pursue selective acquisitions that strengthen core businesses.
- Grow the coffee business at retail and foodservice.
- Extend powdered beverages into new countries and segments.
- Protect and develop local businesses.
- Aggressively reduce costs.
- Capitalize on regional and global leverages.

Germany - (Volume growth of approximately 3.6% CAG and income growth of 8.8% CAG to $81 million in 1993.)

- Broaden HAG trademark presence and volume throughout Europe.
- Broaden and deepen coffee distribution and share in Germany.
- Supply quality freeze-dried coffee to other General Foods units.
- Extend lines in core cheese and Miracoli dinner products.
- Cut costs where possible to maintain margins.

Italy - (Volume growth of approximately 3.5% CAG, income growth of 11.1% CAG to $137 million in 1993.)

- Integrate in sales and distribution three separate Kraft companies.
- Use savings from consolidations and productivity improvements to defend leading market shares of core brands.
- Introduce line extensions and product improvements for core cheese products.
- Improve Simmenthal product mix by growing in canned meat salads.
- Improve cost and share position (to #2) of Mareblu tuna.

United Kingdom - (Volume growth of approximately 4.0% CAG, income growth at 12.7% CAG to $140 million in 1993.)

- Grow share in all coffee segments.
- Expand Maxpax to Continental Europe.
- Launch branded Ready-to-Eat meals in the U.K.
- Market share in processed cheese slices, cream cheese, processed portions, and margarine are projected to remain flat.
- Strengthen presence in cheddar cheese.
- Stimulate volume growth through grocery product transfers such as Miracle Whip.

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- Maintain high market spending to counter growing competition from private label trade.

Spain (Volume growth approximately 10% CAG with income growth at a 48.3% CAG to $33 million in 1993.)

- Financial results driven by volume gains.
- Grow core cheese businesses with line extensions targeted to Spanish market.
- Continue geographic expansion of Saimaza coffee.
- Introduce HAG into decaf coffee segment.

Australia (Volume growth of 1.4% CAG with income growth at a 12.8% CAG to $58 million in 1993.)

- Respond to competitive threats in cheese. Overhaul of milk supply infrastructure required to improve cost position against New Zealand and secure export business to Asia.
- Rationalize existing multiple plant structure for efficiencies.
- Retail grocery business remains strong.

Kraft General Foods Canada Group

	1988	1989	1993	CAG 1988-1993
Division				
Volume (million lbs.)	527	534	579	1.9%
Financial Summary ($ Mil)				
Operating Revenue	$1,411	$1,312	$1,664	3.4%
Income from Operations	$ 167	$ 174	$ 234	7.0%
% of Sales	11.8%	13.3%	14.1%	--
Capital Expenditures	$ 31	$ 46	$ 46	--
Funds Generated from Operations	$ 56	$ 68	$ 162	--
Return on Assets		20.4%	20.3%	--

Objectives

- Integrate the Kraft and General Foods Canadian companies without disrupting existing business.
- Renew core business growth momentum.
- Build margins through productivity and plan for competitiveness under Free Trade.
- Broaden customer focus to the level of consumer focus.
- Develop people and organization for superior execution.
- Acquire new businesses and grow existing ones.
- Defend core franchises, particularly those with high share and margin.

Strategies

- Free trade will require cost structure to be competitive on a North American basis.
- Margin and pricing risks offset by productivity.
- Extend cheese leadership and build profits through line extensions.

- Meet ground coffee profitability targets by achieving coffee blend superiority and introducing Maxwell House line extensions.
- Maintain strong share leadership in pourables and viscous while defending margins.
- Return Hostess to historical industry margins.
- Continue recent successful strategic actions on Main Meals entries.
- Maintain share momentum in cereals by launching successfully two new cereal brands or line extensions early in plan.
- Continue realignment of dessert and beverages to new forms by development and acquisition including Cattelli's dessert business.

- Focus marketing programs on local/regional competition.
- Broaden the portfolio by line extensions (lite, low salt, and lean) and participate in profitable new categories.
- Run existing facilities better.
- Continue aggressive cost reduction programs.
- Provide superior quality and customer service.

Louis Rich Brand

Strategies

- Emphasize high quality, branded products at a premium price.
- Strengthen leading national consumer franchises.
- Leverage sales and distribution systems.
- Develop innovative new products.
- Balance sales mix across distribution channels.
- Increase production capacity to meet the projected 10.2% CAG volume growth by building a west coast facility in Tulare, California and a midwest facility in Sedalia, Missouri.

Development Projects

Strategies

- National introduction of Lunchables by the end of 1990 to allow for economies of scale and increased profits.
- National roll-out of Louis Kemp Crab Delights in 1989 followed by development of other surimi products.
- Expand test of Zappetites line of frozen microwavable snacks to 13% of the U.S. to confirm long-term viability.

Kraft General Foods Frozen Products Group

	1988	1989	1993	CAG 1988-1993
Group				
Volume (million lbs)	1,412	1,465	1,932	6.5%
Financial Summary ($ Mil)				
Operating Revenue	$2,031	$2,378	$3,169	9.3%
Income from Operations	$ 134	$ 186	$ 345	20.8%
% of Sales	6.6%	8.3%	10.9%	--
Capital Expenditures	$ 63	$ 64	$ 48	--
Funds Generated from Operations	$ 154	$ 72	$ 217	--
Return on Assets		14.1%	18.2%	

Industry

- Convenience requirements will fuel the continued growth of this category. Competition will increase from traditional frozen competitors, and from takeout, delivery, and refrigerated items.
- Reformulations and line extensions to address consumer concerns about fat and sugar.

Objectives and Strategies

- Achieve synergies from integration of the various businesses and systems resulting in savings in distribution, purchasing, and R&D.

AAGC (All American)

- Focus on strengthening the core businesses and pursue new products.
- Maintain low cost producer status by continued efficiencies.
- Manage introductory expenses for new products.
- Improve consumer awareness for Budget Gourmet brand.

Tombstone

- Expand geographically across the U.S. and determine best delivery system for expansion.

- Product line extensions in premium and microwave products.
- Achieve low-cost producer position in quality frozen pizza.
- Counter increased competition from takeout and home delivery.

Lenders

- Category continues to grow at double digit rates.
- Grow core retail business and geographically expand Big 'N Crusty.
- Introduce line extensions where appropriate.
- Control cost of goods and of administration.

Dairy Group

- Ice cream, cottage cheese, and sour cream segment declining, while yogurt continues to grow.
- Incremental volume and revenue from low/no fat products.
- Improve productivity and take advantage of direct sales force.
- Develop advantaged business systems in fragmented industry.
- Examine alternatives for a fully integrated manufacturing, distribution, merchandising and communication systems.

Birds Eye

- Build core frozen produce and introduce higher margin products.
- Upgrade package offerings and sizes.
- Consolidate value added products to five microwavable lines.
- Implement cost reductions in sourcing and distribution.

Frozen Desserts

- Novelties category is flat to declining.
- Convert novelties to point-of-sale marketing focus from media.
- Reduce fixed plant costs for novelties and control inventories.
- Compete more fully in Toppings category via Cool Whip line extensions.

U.S. Commercial Products

Division	1983	1988	1989	1993	CAG 1988-1993
Volume (million lbs)	1,803	4,809	5,161	6,271	5.5%
Financial Summary ($ Mil)					
Operating Revenue	$1,162	$3,592	$3,982	$5,420	8.6%
Income from Operations % of Sales	$ 57	$ 103	$ 158	$ 291	23.1%
Capital Expenditures		$ 51	$ 65	$ 72	
Funds Generated from Operations	--	$ 68	$ 148	$ 188	--
Return on Assets	--	--	11.3%	15.4%	--

Industry

- Future growth in the foodservice market is projected to be at a 1.5% to 2% CAG for the next five years. This volume growth exceeds that of food at home. Consolidation in this fragmented industry will continue.
- Demand for Specialty Ingredients from food processors is anticipated to be strong.
- Edible oil use by food processors, foodservice, and private label retail will decline over the plan period.

Foodservice

Objectives

- Manage product and customer mix to focus on winners.
- Improve margins by better pricing and procurement using centralized information and control systems.
- Raise productivity, particularly at acquired business units.
- Maintain growth position and build share.

Strategies

- Star Management Reporting provides for a common information database throughout the organization and identifies profitability by component activity.
- District assessment process assists in determining where and how profits are generated within a district and in managing mix.
- Over time, implement Sandra 90, a standardized integrated information system across the organization.
- Margin improvement program via price realization and cost control.
- Productivity improvement (KPP) throughout division at local and national levels.
- Enhanced marketing to improve volume of Kraft Manufactured, and Kraft Foodservice Distributor brands.

Industrial

Objectives

- Accelerate growth of Specialty Ingredients through volume growth in base businesses.
- Improve profitability of edible oil products in a flat and competitive market via product development and aggressive productivity programs.

Strategies

Ingredients

- Represents 15% of sales and 40% of income of Industrial business.
- Implement cheese leadership plan and reduce cost of Kraft sourced cheese by 4¢ per pound.
- Develop confection line extensions for marshmallow bits and add value to caramel sales.

- Expand product line in spray drying to increase and diversify line.
- Expand via acquisitions, new products, General Foods products, and alliance with a flavor/seasonings supplier.

Oil

- Represents 85% of sales and 60% of income of Industrial business.
- Kraft Grocery is a major customer.
- Reduce costs and headcount and improve working capital turns.
- Improve service levels (to 95% complete and on time) and quality levels (reduce deviation by 20%) in 1989.
- Shift food processor mix toward value added products, as well as packaged and specialty products.
- Develop new private label products for confection, cheese analogs, and shortening.
- Expand Foodservice sales to key national accounts.

MILLER BREWING COMPANY

Industry	1983	1988	1989	1993	CAG 1988-1993
Beer Volume (million bbls)	183.8	187.4	187.6	187.6	0.1%
Division					
Volume (million bbls)	37.5	40.7	42.1	48.3	3.5%
Beer Market Share (%)	20.4%	21.6%	22.3%	25.7%	--
Financial Summary ($ Mil)					
Operating Revenue	$2,933	$3,263	$3,516	$4,643	7.3%
Income from Operations	$ 224	$ 190	$ 220	$ 377	14.7%
% of Sales	7.6%	5.8%	6.3%	8.1%	--
Capital Expenditures	174	$ 86	$ 98	$ 49	--
Funds Generated from Operations	$ 357	$ 245	$ 316	$ 366	--
Return on Assets	6.4%	7.7%	9.3%	17.4%	--

Industry

- The industry is projected to remain essentially flat as slightly positive demographic trends (population growth) will be offset by unfavorable environmental factors (social attitudes, warning labels, and possible excise tax increase).
- Total premium priced category will grow 1% annually, led by low-calorie products (+4.1% annual growth). Above premium, popular, regional and budget brands will decline in excess of 1% annually.

Competition

- Anheuser-Busch volume and share growth/leadership is projected to continue based on its premium-priced segment penetration, on premise distribution and strength among contemporary adult consumers.

- Miller's achievement of its share and volume objectives combined with the continued momentum of Anheuser-Busch will lead to continued volume declines by second tier brewers.

Objectives and Strategies

Strengthen the Miller Franchise by:

- attracting Budweiser's wide consumer base by use of Miller's current line of premium brands against three separate Budweiser user groups;

Increase premium full calorie volume and profitability largely by:

- improving the visibility, masculinity and contemporary appeal of High Life through new packaging and on premise/local event activities; and
- building a national franchise for Genuine Draft with emphasis on maintaining ownership of the "Cold-Filtered Draft" position;

Profitably gain share of the low calorie category by:

- positioning LITE to all drinkers through both national and regional impact programs; and
- introducing a new LITE product leveraging the attributes of Genuine Draft and cold filtration.

Increase the profitability of other brands by:

- maximizing Lowenbrau volume at minimum spending levels; and
- increasing pricing on budget/popular brands.
- participating in the premium dry beer segment.

Operating income growth of 14.7% driven by volume, stabilization of premium brand mix, increased pricing on budget brands and improved marketing and operating efficiencies.

Philip Morris Credit Corporation

	1988	1989	1993	CAG 1998-1993
Revenues	$177.5	$221.8	$520.2	23.8%
Net Income (A)				
PMCC only	$64.4	$78.0	$162.3	20.1%
PMCC including MVRG	$123.3	$129.2	$190.0	10.1%
Total Assets	$3,271.7	$3,914.6	$8,179.9	
Investment Program	$516.0	$734.0	$1,200.0	
Total Debt	$1,503.9	$1,833.8	$3,616.1	
Reduction in income taxes paid	$214.1	$290.0	$478.0	
Return on Equity				
PMCC only	27.3%	29.9%	27.1%	
PMCC including MVRG	21.6%	19.3%	16.9%	

(A) 1988 excludes FAS 96 net income gains of $7.8 million for PMCC and $33.1 million for MVRG.

Strategies and Objectives

- Save taxes by building a portfolio of financial assets with high quality credit characteristics.
- Increase PMCC's investment in customer and supplier financing.
- Continue the successful strategy of the transformation of MVRG to a land development group.
- Employ the strategies and investment guidelines successful in the past for the leasing and preferred stock/tax exempt debt areas.
- Minimize borrowing costs by accessing worldwide capital markets.
- Maximize PM's return on capital invested in PMCC and maintain an annual net earnings growth rate of at least 20%.
- Develop the systems and organization necessary to accommodate a high volume of transactions.

FINANCIAL
ANALYSIS

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Financial Analysis

PHILIP MORRIS

CORPORATE FINANCIAL ANALYSIS

The 1989-1993 Five Year Plan forecasts growth in operating revenues at almost twice the rate in the previous plan, and accelerated growth in income from operations and in net income. The five year growth rates reflect the impact of the Kraft acquisition. The base year 1988 includes only one month performance for Kraft. Excluding Kraft, PM revenue is projected to increase at almost the same rate as the previous plan (7.7% vs. 7.6%). Income from operations, excluding Kraft, is anticipated to have a five year growth rate of 16.3% compared to a growth rate of 13.9% in the previous plan. Including Kraft, revenue and income from operations are expected to have five year growth rates of 14.4% and 20.1% respectively. Our tobacco businesses continue to be the main contributors to both revenue and earnings growth.

The financial statements on which the following analysis is based include several changes in accounting practices in compliance with recently issued statements of the Financial Accounting Standards Board (FASB). The company's financial services and real estate subsidiaries are now consolidated where they had previously been accounted for by the equity method (FAS 94). The cash flow statements are in a different format from prior years (FAS 95). The company has also adopted new income and deferred tax accounting principles (FAS 96). The 1988 statements include a one time cumulative adjustment for the tax effects of prior periods. Except for the effects of FAS 96, prior years have been restated to conform to these rulings. The effects of the FASB proposed rules on accounting for the cost of retiree health care and life insurance benefits have not been determined at this time and have not been included in these plan calculations.

Assets will increase at a lower rate than earnings, since the Kraft acquisition assets are built into the base year of the plan financial projections. Almost two thirds of projected capital expenditures will be directed toward food operations, which will continue to comprise a majority of corporate operating assets. The tobacco, food and beverage operating companies will generate excess cash flow over the plan period. The cash flow will be applied to capital expenditures, debt reduction and increased dividends. The Debt to Equity ratio, which is at a high of 2.14 at 1988 year-end due to the financing of the Kraft acquisition, will decline to .23 by 1993, excluding the effects of finance company debt.

Corporate return on assets was 13.3% in 1988, will be 11.2% in 1989, and will increase significantly to 17.7% by the end of the plan period in 1993. Return on shareholders' equity starts from 32.2% in 1988, climbs to 32.7% in 1990, and decreases slightly to 31.7% in 1993 due to decreased use of leverage on the balance sheet. Overall, this plan sees a continuation of Philip Morris' historic growth patterns in profitability, and a further strengthening of our balance sheet and general financial position.

Income Statement

Consolidated revenues are projected to grow 14.4% per annum from $31.7 billion in 1988 to $62.1 billion in 1993. Excluding the Kraft acquisition, consolidated revenues are estimated to grow at 7.7%, a slightly higher growth rate than the 7.6% projected in the 1988-92 plan. The revenue growth reflects the $13.1 billion 1989 addition of Kraft revenues, unit volume growth, price increases at all operating companies and excise tax increase in various international cigarette markets. No federal excise tax

increase in the U.S.A. cigarette or beer markets is included. Revenue from tobacco products will decrease from 52.3% of total revenue in 1988 to 41.1% in 1993, but up from 38% in 1989. The following table outlines the contributions to revenues of our various business segments:

	Contribution to Total Corporate Revenue			
	1983	1988	1989	1993
P.M. USA	42%	27%	21%	23%
P.M. INTERNATIONAL	27	25	17	18
TOTAL TOBACCO	69%	52%	38%	41%
G.F. USA	-	14	11	10
KRAFT U.S.A.	-	1	10	9
KRAFT - G.F. INTERNATIONAL	-	11	10	9
KRAFT - G.F. CANADA	-	1	3	3
OSCAR MAYER	-	7	5	5
KRAFT - G.F. FROZEN	-	1	5	5
USA COMMERCIAL	-	1	9	9
TOTAL KRAFT GENERAL FOODS	-	36%	53%	50%
MILLER	22	10	8	8
OTHER	9	2	1	1
TOTAL FOOD, BEVERAGE & OTHER	31%	48%	62%	59%
TOTAL	100%	100%	100%	100%

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Available profit is projected to increase from $12.3 billion in 1988 to $25.3 billion in 1993, growing at a 15.5% annual rate. Excluding Kraft, available profit is projected to increase from $12.1 billion to $19.7 billion, an annual growth rate of 10.3%. The available profit margin as a percent of revenues, including Kraft, rises 2.0 percentage points from 38.8% to 40.8%. PM USA is the major contributor to the available profit margin increase (rising from 55.4% to 63.6%) because of selling price increases and moderate leaf cost inflation. PM International's margin increases from 26.1% to 28.9%, Kraft General Foods' increases from 34% on a pro-forma basis in 1988 to 36%, and Miller's is relatively flat from 27.7% to 27.9%. With the exception of PM USA, overall price increases will be in line with or slightly ahead of inflationary trends. However, we expect continued moderation in the costs of raw materials.

Marketing expenditures will rise from $6.1 billion in 1988 to $11.6 billion in 1993, or 13.7% annually. Excluding Kraft, marketing expenditures would increase at 7.4% annually. General and Administrative expenses increase 11.0% annually to $1.6 billion by 1993. Excluding Kraft, G&A expenses would increase 4.0% annually by 1993. Kraft is projected to grow G&A expenses at an annual rate of 3.1% from 1988 to 1993. R&D expenses grow at 9.8% over the plan period. The overall rate of increase in total fixed expenses will be 12.1%, from $6.4 billion in 1988 to $13.6 billion in 1993.

Income from operations rises from $4.7 billion in 1988 to $11.8 billion in 1993, an increase of 20.1% per annum. Tobacco will account for almost two-thirds of income in each year of the plan, versus four fifths in 1988, prior to the effects of the Kraft acquisition.

	Contribution To Income from Operations			
	1983	1988	1989	1993
P.M. USA	67%	66%	51%	52%
P.M. INTERNATIONAL	19	16	14	14%
TOTAL TOBACCO	86%	82%	65%	66%
G.F. USA	-	7	6	6
KRAFT USA	-	1	11	10
KRAFT - G.F. INTERNATIONAL	-	5	5	5
KRAFT - G.F. CANADA	-	1	2	1
OSCAR MAYER	-	4	3	2
KRAFT - G.F. FROZEN	-	-	2	3
USA COMMERCIAL	-	-	2	2
FOOD RESTRUCTURING	-	(7)	-	-
TOTAL KRAFT GENERAL FOODS	-	11%	31%	29%
MILLER	11	4	3	3
PM CREDIT CORP	1	1	1	2
OTHER	2	2	-	-
TOTAL FOOD, BEVERAGE & OTHER	14%	18%	35%	34%
Total	100%	100%	100%	100%

Non-operating deductions peak in 1989 at 5.3% of revenues and decline to 2.4% to in 1993. Net interest expense of $670 million in 1988, due mainly to the debt related to the General Foods acquisition, increases in 1989 to $1.8 billion due to the financing of the Kraft acquisition and declines to $815 million in 1993 due to debt reduction.

Exclusive of a pre-tax corporate adjustment which is viewed as a contingency against possible unfavorable business developments, the effect of the decline in non-operating deductions is to translate the projected annual 20.1% income from operations growth rate to 22.6% for pre-tax income. The corporate adjustment amounts to $400 million in 1990 and rises to $550 million in 1993. Including these adjustments, pretax income increase 21.3% annually from $3.7 billion in 1988 to $9.8 billion in 1993.

Income before the cumulative adjustment for the change in accounting for income taxes required by FASB Statement 96 of $273.4 million is projected to increase at the annual rate of 23.2%, aided by the decline in the overall effective tax rate to about 40% as a result of the 1986 tax law rate changes. Net income increases on average by 20.2% per year to $5.9 billion in 1993 from $2.3 billion in 1988. The net income margin of 7% in 1988, exceeds 9% in 1993.

Projected EPS annual growth of 20.0% approximates net income growth. EPS increases from $11.00 in 1988 to $24.98 in 1993. The average number of shares outstanding will increase slightly from 233 million in 1988 to 235 million in 1993.

Dividends

The annual dividend rate is scheduled to increase to $11.00 per share in 1993 from 1988's $4.50, or at an 19.6% annual rate. The payout ratio rises from 40.3% in 1988 to 42.7% in 1989 and returns to a more traditional level of 40.1% in 1993; over the plan period we will reassess our dividend policy.

Capital Expenditures

Capital expenditures are projected to total $5.5 billion throughout the plan period. A little less than two thirds, amounting to $3.5 billion, will be dedicated to facilities at Kraft General Foods. PM USA proposes to spend $900 million, Miller $400 million, and PM International $500 million. Over the 1989-93 plan-period depreciation and amortization will total $6.8 billion, meaning that operations provide the funding required to finance capital expenditures. Major capital expenditures are projected to include continued domestic tobacco modernization programs, expenses related to the reopening of the Trenton brewery, investments in a modern cheese facility, standardized information systems for foodservice, cereal processing facilities, turkey processing facilities, distribution warehouses as well as overall equipment upgrades and replacements.

Balance Sheet

Total assets are projected to increase 16.9% over the plan period, from $37.0 billion in 1988 to $43.2 billion in 1993, or at a 3.2% annual rate. Due to the repayment of $11.6 billion in long and short term debt, cash balances are projected to remain constant through 1993. However, the portfolio of marketable securities included in PMCC's finance assets will increase $750 million to $1.5 billion in 1993. PM will continue to have debt of $4.7 billion on the balance sheet in 1993, attributable to consumer products, and $3.6 billion of debt attributable to finance and real estate companies activities.

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The majority of our operating assets will be invested in food operations, and the breakdown is as follows:

Composition of Consolidated Total Operating Company Assets

	1983	1988	1989	1993
P.M. USA	28%	10%	12%	11%
P.M. INTERNATIONAL	31	8	8	9
TOTAL TOBACCO	59%	18%	20%	20%
GF USA	-	8	7	7%
KRAFT USA	-	3	3	4
KRAFT - GF INTERNATIONAL	-	5	6	6
KRAFT - GF CANADA	-	2	2	2
OSCAR MAYER	-	2	3	3
KRAFT - GF FROZEN	-	2	2	3
USA COMMERCIAL	-	2	2	3
KRAFT - GF CORPORATE	-	44	42	33
TOTAL KRAFT - GF	-	68	67%	61%
MILLER	20%	4%	4%	3%
PMCC	8	9	8	16
OTHER	13	1	1	-
TOTAL FOOD, BEVERAGE OTHER	41%	82%	80%	80%
TOTAL	100%	100%	100%	100%

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Goodwill comprises 65% of Kraft General Foods assets in 1988 and 54% in 1993. The asset base for 1983 has been restated to reflect the full consolidation of the assets and liabilities of PMCC and Mission Viejo in accordance with FAS 94.

Total equity almost triples over the plan period, reaching $20.3 billion in 1993 as compared with $7.7 billion in 1988. The debt/equity ratio of consumer products declines progressively from 2.14 in 1988 to .23 in 1993, with a debt balance in 1993 of $ 4.7 billion. Consolidated with PMCC, debt decreases from $17.9 billion in 1988 to $8.3 billion in 1993 and the debt/equity ratio declines from 2.34 in 1988 to .41 in 1993.

Funds Flow

Operations generate $27.6 billion over the next five years, $20.8 billion from net income and $6.2 billion from depreciation and amortization. All consumer product operating companies are cash generators over the plan period. Debt reduction aborbs $11.6 billion. Finance and real estate investing activities will require $4.7 billion of funds which will be financed by earnings of $0.7 billion, deferred taxes of $2.2 billion and net increase in finance company debt of $2.0 billion. Dividends will require $8.0 billion of the funds generated. Capital expenditures will account for $5.5 billion and major working major capital items (excluding cash and current debt) another $1.1 billion.

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Returns

The consolidated operating companies all project improvement in after tax return on assets as follows:

Return on Assets

	1988	1989	1990	1991	1992	1993
PM USA	71.5%	79.7%	82.2%	90.3%	101.6%	114.9%
PM International	11.5%	18.5%	19.9%	21.1%	22.8%	24.9%
Miller	7.7%	9.3%	10.7%	12.4%	14.5%	17.4%
Kraft - GF	8.8%*	12.2%	12.7%	13.6%	14.5%	15.3%
PMCC	4.7%	4.5%	4.7%	4.6%	4.5%	4.6%
Consolidated	13.3%	11.2%	12.5%	13.9%	15.6%	17.7%

* General Foods only. Excludes the 1988 restructuring change.

Consolidated returns on assets are forecast to improve to 17.7% in 1993. Profit margin expansion, lower financing costs, good will amortization and lower taxes are key factors in the improvement. Return on equity will rise only slightly, from 32.2% in 1988 to reach a high of 32.7% in 1990 then will decline to 31.7% in 1993, reflecting decreased use of leverage on the balance sheet.

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PHILIP MORRIS

Key Issues

KEY ISSUES

The acquisition of Kraft Inc. met the previous plan objective to expand our food and beverage businesses and effectively use our substantial cash resources. Throughout the plan period, our goal will be to use the assets of the corporation to generate maximum value for our shareholders and superior quality for our customers.

Over the next five years, strategy formulation will be influenced by five key issues:

1. Improvement of shareholder value.
2. Managing the organization.
3. Environmental issues.
4. Outlook for branded consumer products.
5. Divestitures and acquisitions.

Improvement of Shareholder Value

Our performance during previous plan periods has significantly enhanced shareholder value. For the ten years ending December 31, 1988, Philip Morris's stock price has posted average annual increases of 19.1% -- exceeding most competitors. During the same period, earnings per share expanded at an annual rate of 19.5%. Total return to investors over the last five years was 25.8% which also compares favorably with other leading consumer products companies.

Despite growth in earnings and exceptional cash flow, the market continues to discount Philip Morris stock. At the end of 1988, our price-earnings multiple was 10.2 compared to 12.8 for the Standard & Poor's 500. By March 31, 1989, the gap narrowed. Our multiple jumped to 12.0 while the S&P 500 edged up to 13.0 times earnings. This improved valuation

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may reflect the increased contribution of income from food and beverage products; expectations that our history of superior business performance will continue; and a lessening of investors' concerns about tobacco product liability.

Superior business performance remains our primary approach for enhancing shareholder value. Four thrusts will drive the corporation toward this goal during the 1989-93 period:

1. Utilize better the assets of the core businesses.

2. Integrate food operations into the Kraft General Foods Group and achieve better results from our food business.

3. Redesign certain programs to take advantage of our size and implement appropriate synergies.

4. Refine our portfolio of businesses through divestitures and acquisitions.

We also intend to use the wide array of financial strategies available to ensure that shareholders realize increased returns on their investment. Dividend payments will remain at high levels. Dividends declared are projected to grow from $4.05/share in 1988 to $10.00/share in 1993. In total, $8.0 billion in dividends will be distributed to shareholders over the plan period. Share repurchases will also be considered during this period.

Several competitors have undergone major capital restructurings in an effort to improve returns to shareholders, some in the face of external threats. Outstanding operating results have allowed Philip Morris to reward investors through long-term price appreciation and dividend growth. We will continue to explore all available options to ensure that our capital structure satisfies the needs of the corporation and the expectations of our shareholders.

Managing the Organization

As noted earlier, the acquisition of Kraft represents the achievement of a major strategic objective discussed in previous plans. Kraft brings to Philip Morris leading franchises, a strong international presence and an experienced management team. With Kraft, our food operations have doubled in size and the corporation's lines of business have become increasingly diverse.

By the end of the plan period, Philip Morris's net income is expected to total almost $5.9 billion on revenues of over $62 billion. As a result, our most important challenge over the next five years is effectively managing the world's largest packaged goods company.

Our goal is to develop a structure which fosters and rewards individual initiative without sacrificing cooperation and timeliness; sets standards for excellence; and encourages communication not only among management and business units but also across operating and divisional lines. Through collaboration, the competitive advantage of individual business units will be enhanced and decision making sharpened. Front-line managers will be rewarded for creativity and sensible risk-taking.

In managing the organization, we aim to seize one-time incremental earnings while laying the foundation for more lasting benefits. Some steps have already been taken. At year end 1988 we undertook a restructuring program at General Foods which included closing the desserts plant in Lafayette, Indiana; consolidation of coffee manufacturing facilities; early retirement programs and other cost reductions. Major ongoing productivity programs, such as used by Kraft, are planned throughout the organization and will yield tangible benefits.

Benefits will also come from the joining of our food operations into the Kraft General Foods Group. The group, headquartered in Glenview, Illinois, consists of seven new operating units. Integration will allow us to capitalize on the benefits of our management talent, sales and distribution capabilities, solid brand line-up and R&D resources. We expect the combination to produce strong results early in the plan period.

Our corporate size offers strategic opportunities available to only a handful of competitors. Many efficiencies in procurement as well as sales and trade promotion have already been realized. Our size should counter the growing power of the trade and ameliorate trade dealing. In consumer marketing, we will benefit from combined media buying, more favorable advertising rates and the ability to transfer brand names across categories. The resources of PMCC will also be tapped to enhance competitiveness.

Shared technological expertise will have an impact on new product development. By pooling R&D efforts and engineering findings we will accelerate the pace of innovation while continuing to improve product quality.

Size yields advantages not only across operating units but throughout the corporation as a whole. These include a lower cost of capital, stronger business systems and greater resources to respond to external concerns. We must make certain that size does not mean bureaucracy and slowness to respond.

Environmental Issues

Increased government intervention

Our core businesses will face intense legal, legislative and regulatory pressures throughout the plan period. In domestic tobacco, anti-smoking forces are expected to increase their efforts. Despite some recent successes, many product liability cases remain pending. We will fully defend our position in each individual action.

Ongoing legislative efforts to curb smoking include increased excise taxes; restrictions on marketing activities; and limiting areas where smoking is allowed. We will continue to fight initiatives such as these which curtail the civil liberties of customers and private enterprise. Our regional corporate affairs network will spearhead the campaign to ensure that decision-makers hear the voices of smokers. Philip Morris Magazine and Smokers Newsletters have enhanced our ability to communicate the views of the smoking constituency.

Our freedom to market beer may also be threatened by similar legislative actions. Efforts to increase excise taxes, mandate unfavorable labeling, restrict advertising and curtail distribution are likely throughout the plan period. The Corporate Affairs Department will coordinate an organized response to all such attacks.

Food labeling, ingredient listing, and health endorsements by private organizations will also be issues to confront in the plan period.

Fat replacement and nutrition

Consumer interest in health and nutrition will be a significant factor in the food industry over the next five years. Fat has replaced sodium and

sugar as the ingredient most troubling to consumers. Concern about cholesterol is also growing.

Kraft is at the forefront of fat replacement technology. Significant investments have been made which are expected to create opportunities for more reduced-fat and fat-free products. Kraft's strategy is to lead the market with fat-free line extensions in core categories.

Other health and nutrition concerns about food and their packaging are prevalent. We should be positioned so that our branded packaged consumer products can satisfy these concerns and take advantage of this position.

International business conditions

The changing structure of international markets offers unprecedented challenges for us overseas.

The European Community's (EC) plan to establish a barrier-free Europe by the end of 1992 is expected to accelerate economic growth and alter the cost of doing business in a market of 320 million people. The Philip Morris businesses are well-positioned as the EC continues to grapple with critical issues such as taxes, currency and product standards. The impact will vary depending on the lines of businesses involved. We will continue to monitor and influence policy on these issues and take steps to solidify our competitive position.

Competition in the Canadian market is likely to intensify as tariffs are reduced under the Free Trade Agreement between the U.S. and Canada. Kraft General Foods Canada was formed to consolidate our resources in Canada. Scale economies resulting from the combined organizations will help defend against downward pressure on margins. Unified North American sourcing will allow us to take full advantage of falling trade barriers.

Opportunities and challenges will be created for various food products and possibly, beer.

Australia and New Zealand have concluded a bilateral trade agreement. Closer economic relations between the two countries introduces a new challenge for Kraft. While New Zealand and Australia are among the most efficient dairy producers in the world, New Zealand has historically had a significant cost advantage in cheese and is expected to compete aggressively in Australia. The Asia-Pacific area is an important market for Philip Morris products and for future growth.

Progress made in such areas as government relations and strengthening of key business systems will prove valuable as Philip Morris companies penetrate further into the European and Asia-Pacific regions.

Domestic business conditions

The structure of domestic markets is also changing. Two trends will be of particular importance to Philip Morris. First, the $25 billion buyout of RJR Nabisco shattered the notion that size alone can ward off takeovers. Second, the trend toward consolidation in the food industry is likely to continue. Both domestic and foreign competitors seek growth and market share through acquisition of established brands. We are aware of these trends and actions are in place to address these issues.

Outlook for Branded Consumer Products

As in previous years, a primary business objective is profitable unit volume growth. Meeting this objective is a continual challenge. Our core markets are already large, profitable and highly competitive.

To date, we've had success in stimulating growth through line extensions, technological innovation, new product development and international expansion. For example, Philip Morris's domestic tobacco volume is expected to grow 1.4% annually despite a projected drop in industry volume of 3.0% a year. By 1993, our share of the domestic tobacco market is expected to reach 49%.

The acquisition of Kraft broadens the range of our growth prospects available in the food industry. Kraft and General Foods together account for 18 of the top 50 U.S. food brands. This stable of household food names yields several important advantages to Philip Morris. Leading brands often command premium prices resulting from their quality and consistency. The costs and risks of new products can be minimized by extending established franchises to new forms. Additionally, increased availability of branded food items via expanded distribution to foodservice outlets and convenience stores will contribute to volume growth.

To meet profit targets, we will put substantial resources behind our brands to increase market share and improve category growth. Allocation of resources within the portfolio of businesses will be determined by relative performance and investment opportunities. Within the business units, strategies will vary to exploit the key factors which will allow Philip Morris to outperform competitors and generate maximum returns.

Kraft also expands our food presence overseas. The majority of Kraft products are ranked first or second in major markets around the world. Combined with General Foods products and the strength of our tobacco operations, we should have the resources to influence industry issues. Our food businesses are, however, underrepresented in Asia, one of the fastest growing areas in the world. The Kraft General Foods Group will take an

active role in developing this market through internal and external expansion programs.

Divestitures and Acquisitions

We completed the $12.9 billion acquisition of Kraft Inc. in December 1988. As a result of the transaction, the debt-equity level rose to 2.14 by year end 1988. With strong cash flow projected, debt levels will be substantially reduced by the end of the plan period.

An effective marketer of branded consumer products, Kraft is a leader in growing, prosperous segments of the food industry and has a significant international presence. With little overlap in product lines, we gain avenues into new markets. Finally, the contribution of Kraft's income will make food a larger and stronger source of earnings.

The entire portfolio of food businesses will be refined according to strategic fit and performance. Divestitures and asset realignments will continue throughout the plan period. Based on the results of our experience managing the businesses, we will also consider acquisitions which will enhance or expand our competitive position.

Throughout the plan period, all free cash flow will be used first to retire scheduled long-term debt, then short-term acquisition debt. By the end of the plan period, total available funds will reach $36 billion (based on a debt-equity ratio of 2 to 1 for Consumer Products).

During the plan period, we will continue to revisit the issue of how to maximize returns to our shareholders. Possibilities include another major strategic acquisition, a series of complementary acquisitions, dividend increases, stock repurchases, and the combination of these elements.

PHILIP MORRIS U.S.A.

Philip Morris U.S.A.

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of Philip Morris U.S.A.'s forecasted U.S. cigarette industry environment.

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PLAN OVERVIEW

Philip Morris USA's Five Year Plan contains the marketing, sociopolitical and operations strategies which will be employed to achieve continued growth. Last year's Plan initiated strategies to accelerate volume and share growth by increased investment in the cigarette business while concurrently increasing profitability and cash flow. PM-USA's 1988 performance met our goal of accelerating volume, market share and operating income growth. Despite some significant changes in the industry -- KKR's acquisition of RJR Nabisco and the possible emergence of a third price tier -- we are confident that overall, our business strategy positions PM-USA to meet future challenges and capitalize on opportunities in the market place. As a result, PM-USA's Five Year Plan objectives remain aggressive, including:

- Volume growth of 15.9 billion units and a 9.7 market share point gain over the next five years to 49.0 percent of the industry, despite a projected industry decline of 78.3 billion units.
- Share growth in both the full margin and price/value categories of 9.8 percent and 16.5 percent over the next five years, reaching category shares of 51.4 percent and 37.4 percent respectively by 1993.
- Accelerated new product programs to respond to changing consumer tastes.
- Continued investment in the cigarette business, including new assets and technologies where appropriate.
- Operating income growth averaging 14.8 percent annually.
- Cumulative after-tax cash flow of $14.0 billion.

These objectives match or exceed last year's Plan with the exception of forecasted volume growth, which was reduced 1.7 billion units due to the 25¢ per pack excise tax increase in California in 1988 -- a state which accounts for 10 percent of industry sales and where PM-USA has a market share of approximately 50 percent. PM-USA's volume objective should also be viewed in the context of our competitors, who are forecasted to lose a total of 94 billion units over the next five years as the industry declines.

To accomplish our objectives, PM-USA will continue to employ the following strategies:

- Strengthen brand images through strong media and promotional support.
- Improve the availability and visibility of PM-USA's brands by expanding retail presence and depth of inventory in all major trade classes.
- Continue our momentum in the price/value category through competitive pricing offers, retail positioning and new product introductions.
- Pursue an aggressive new product strategy featuring technologically innovative product concepts. Where appropriate, technology products will be

enhanced by leveraging existing brand imagery and heritage.

- Maximize cost efficiencies throughout PM-USA. To this end, efforts will be made to reduce overhead cost in every area of the business.
- Meet growing production requirements within existing facilities, while maintaining manufacturing flexibility, improving product quality and ensuring a stable supply of quality leaf tobacco.
- Protect industry volume by appropriately responding to anti-smoking attacks and defending the rights of smokers and manufacturers.

COMPARISON OF PLAN ASSUMPTIONS AND PM-USA OBJECTIVES

	1988-1992 Five Year Plan	1989-1993 Five Year Plan
Industry		
Annual Volume Decline	-2.8%	-3.0%
Federal Excise Tax	$8.00/M	$8.00/M
Price/Value Share in Last Year of Plan	21.9% (1992)	25.2% (1993)
PM-USA		
Total Market Share Growth	9.4%	9.7%
PM-USA Share of Category in Last Year of Plan:		
Total Industry	47.0% (1992)	49.0% (1993)
Full Margin	49.7%	51.4%
Price/Value	35.0%	37.4%
Total Full Margin Price Increases	$20.5/M	$26.0/M
Total Volume Growth (Billion units)	17.4	15.9
Annual Operating Income Growth	13.4%	14.8%
Total After Tax Cash Flow (Billions)	$11.6	$14.0

1988 Performance

In 1988, PM-USA enhanced our leadership position in most industry categories and further penetrated segments where we have historically been underrepresented, such as menthol and price/value. In doing this, PM-USA recorded the largest volume gains of any manufacturer in both the full margin and price/value categories.

Marlboro increased 4.2 billion units last year to 138.8 billion units on the strength of Marlboro Lights and the successful introduction of new Menthol Lights packings. No other full margin brand gained over 1.8 billion units in 1988. Although Marlboro's growth was offset by a decline in our other full margin brands, PM-USA's share of the full margin category increased 1.2 share points to 41.6 percent due to a 15.7 billion decline for competitors' full margin brands.

Cambridge increased volume and market share by 3.4 billion units and 0.6 share points respectively in 1988. PM-USA also prepared Alpine, the first

generic priced freestanding menthol, for its January 1989 national introduction after a successful test market. In total, our efforts in the price/value arena increased our penetration to 20.9 percent of the category, a gain of 5.4 share points.

As seen in the chart below, our volume gains, in combination with higher pricing, resulted in accelerated operating income growth of 13.7 percent to $3.1 billion and after-tax operating cash flow of $2.1 billion. The increased 1988 cash flow reflects the impact of PM-USA's year-end cash conservation program. Even though PM-USA exceeded its volume commitment for the year, our market share gain of 1.5 share points was below forecast. This was due primarily to higher competitive loading resulting in an industry volume decline of 2.1 percent versus a forecasted 2.8 percent in last year's plan.

1988 PERFORMANCE VERSUS OBJECTIVES

	1988 PERFORMANCE	1988 OBJECTIVE
UNIT VOLUME		
• Volume	221.7	221.6
• Market Share	39.3%	39.5%
PROFITABILITY		
• Operating Income Growth	13.7%	13.5%
• After-Tax Return on Assets	71.5%	69.5%
• After-Tax Cash Flow (Billions)	$2.1	$1.5
RETAIL		
• Carton Rack Rows (000's)	3,825	3,750
• Carton Fixtures	15,300	14,000
• Counter Pack Displays	93,000	92,000
• Overhead Pack Merchandisers	47,600	46,000
OPERATIONS		
• Constant Dollar Productivity Savings (Millions)	$29.0	$7.6
• Reduction in Constant Dollar Manufacturing Cost Per 1000	$.10	$.03
• People Savings From Capital Expenditures *	38	228
• Composite Cigarettes Per Labor Hour	17,200	16,400

* Timing of the 228 positions anticipated on December 31, 1988 will be achieved by April 1989.

Pricing Strategy

Over the plan period, PM-USA will continue to utilize price increases along with volume and productivity gains to accelerate PM-USA's profit growth. Manufacturer list prices increased $4.00 per thousand on full margin products and $5.00 per thousand on branded generics in 1988. While these increases were in line with last year's Five Year Plan forecast, they are significantly above

pricing levels seen just three years ago when prices increased $2.00 per thousand on all cigarettes.

Manufacturer price increases and rising state excise taxes have caused retail cigarette prices to annually increase 8.7 percent on full margin products over the last five years versus 3.2 percent and 6.2 percent respectively for the consumer price index and disposable income per capita. While the industry has provided alternatives such as branded generics and couponing to mitigate pricing impacts to levels below that of inflation, nearly 90 percent of smokers still use full margin products which are either not couponed or are couponed inconsistently.

PM-USA expects industry pricing to remain aggressive as competitors continue to rely on pricing for profit growth. In December 1988, manufacturers increased prices $2.50 per thousand on all cigarettes, in excess of the $2.00 per thousand forecast in last year's plan. Over the plan period full margin retail prices are forecasted to rise approximately 10 percent annually versus an increase of 5.8 percent in disposable income per capita. This will push average retail pack prices over the $2.00 level by 1993 compared to $1.33 in 1988. Higher prices provide manufacturers with resources to either reinvest in the business or enhance profitability, however there are several inherent risks in this trend:

- Higher prices will provide an economic justification for smokers to reduce cigarette consumption or switch to price/value products.

- Higher manufacturer price increases will allow competitors to raise couponing rates and values for both full margin and price/value products. This will continue to put pressure on PM-USA brands which are not widely couponed. In addition, higher prices will provide more incentives to introduce third tier price alternatives.

PM-USA's Five Year Plan includes strategies to address these risks. Marlboro's 19.1 billion unit increase since the 1983 FET increase is evidence that our strategy of strong brand imagery provides a foundation for growth despite heightened consumer price consciousness. Over the plan period, we will continue to invest resources to differentiate our brands with superior images and product quality as well as a broad menu of product incentives which provide added value and reward consumer loyalty. In addition, PM-USA will test several defensive strategies including targeted couponing, concentrated geographic marketing and line extensions to protect full margin brands such as B&H, Merit and Virginia Slims.

For price conscious consumers, PM-USA will provide competitive pricing offers on brands such as Cambridge and Alpine. However, price offers alone can easily be matched by our competitors. PM-USA will continue to complement our competitive pricing strategy with superior quality and taste to position our price/value products favorably to the competition.

VOLUME GROWTH

PM-USA is the only manufacturer in the industry to combine pricing and volume gains to enhance operating income growth. Our Five Year Plan forecast calls for domestic volume growth of 15.7 billion units to 235 billion by 1993, despite an accelerated industry volume decline averaging 3.0 percent annually.

This will result in a market share of 49.0 percent by 1993, an increase of 9.7 share points over the next five years. PM-USA's strategy for volume growth is forecasted to come from both the full margin and price/value categories, principally Marlboro, Cambridge, Alpine and new products.

As mentioned earlier, one of the outcomes of the industry's aggressive pricing will be increased price/value development -- perhaps led by the advent of a new tier of products priced at sub-generic levels. Should this segment develop, PM-USA will become an early active participant in the new category. We have projected a third price tier into our financial forecast and have estimated that by 1993 it could result in an additional shift of 14.3 billion units (versus the chart below) from PM-USA's full margin business to our price/value entries.

PM-USA FORECASTED VOLUME AND SHARE

	UNIT VOLUME (BILLIONS)			MARKET SHARE		
	1988	1993	CHANGE	1988	1993	CHANGE
MARLBORO	138.8	139.0	0.2	24.9%	29.0%	4.1%
BENSON & HEDGES	21.9	17.2	(4.7)	3.9	3.6	(0.3)
MERIT	21.4	18.1	(3.3)	3.8	3.8	0.0
VIRGINIA SLIMS	16.9	15.4	(1.5)	3.0	3.2	0.2
OTHER	7.3	5.2	(2.1)	1.4	1.1	(0.3)
NEW PRODUCTS (FULL MARGIN)	-	9.3	9.3	-	1.9	1.9
TOTAL FULL MARGIN	206.3	204.2	(2.1)	37.0%	42.6%	5.6%
PRICE/VALUE	12.5	20.9	8.4	2.2%	4.4%	2.2%
NEW PRODUCTS (PRICE/VALUE)	0.5	9.9	9.4	0.1	2.0	1.9
TOTAL DOMESTIC VOLUME	219.3	235.0	15.7	39.3%	49.0%	9.7%
OVERSEAS MILITARY	2.4	2.6	0.2			
TOTAL PM-USA VOLUME	221.7	237.6	15.9			

Industry Volume

Domestic cigarette shipments declined 12.2 billion to 557.8 billion units in 1988, continuing a trend which began with the doubling of the federal excise tax in 1983. Since that time, shipments have fallen some 65 billion units for an average annual decline of 1.8 percent. This is in sharp contrast to the five years leading up to the federal excise tax increase when industry volume grew 21.3 billion units or 0.7 percent annually reaching 622.3 billion units in 1982.

In addition to the probable decline in consumption associated with higher pricing, the industry continues to be impacted by threats in the political, business and social arenas. These include excise tax increases, marketing restrictions, proliferation of smoking restriction laws and overall anti-smoking propaganda. Over the plan period, PM-USA expects these threats to intensify.

resulting in a decline in industry volume of approximately 3.0 percent annually to 479.5 billion units by 1993. This decline rate is higher than the 2.1 percent decline in 1988, however it is basically comparable to last year's forecast.

PM-USA's assumptions for incidence, consumption and population growth over the next five years include the following:

- Smoking incidence in the adult population will decline at a rate approximating the last five years, when incidence dropped about three percent. Smoking incidence is projected to be approximately 27 percent by the end of the plan period, down from 30 percent in 1988. These declines will be distributed among both men and women, who will have estimated incidence levels of 30 percent and 25 percent respectively in 1993.

- Based on an annual study by the University of Michigan, start rates among young adults will remain flat at about 14 percent, significantly below the 23 percent exhibited a decade ago.

- Average daily consumption is forecasted to decline about 2.5 cigarettes per day, reflecting the cumulative impact of increasing smoking restrictions and social pressure on smokers.

- The U.S. smoking age population will grow at 75 percent of the rate of the previous five years. In addition, a larger percentage of the population will enter age groups which have exhibited consumption declines. By 1993, 62 percent of the adult population will be over age 35 compared to 59 percent in 1988.

Competitive Environment

Another challenge to PM-USA over the plan period is our competitors' continued utilization of more radical strategies designed to reverse PM-USA's momentum. These measures include aggressive retail price competition, targeted advertising and consumer programs and the introduction of high technology products. Competitors will attempt to broaden their customer base and erode PM-USA's strong showing in particular among adult smokers under age 25 to achieve long-term growth. Our brands now account for 68 percent of this category versus 16 percent for RJR, and 16 percent for the remainder of the industry.

Several events occurred in 1988 which could impact the future competitive environment. The favorable ruling in the Cipollone case lowered concerns over product liability, which led to KKR competing with RJR Nabisco management for control of the company. Without a dramatic shift in investor perception, it is possible that the ownership of other competitors could change hands over the plan period. KKR's actions will be monitored closely to determine changes in operating philosophy and identify opportunities for PM-USA. Whatever the situation, PM-USA will take RJR as well as smaller competitors most seriously. Our own history reminds us that a small determined and opportunistic company can be successful against seemingly impenetrable competitors.

Technology is also being tested as a means of "changing the game" by addressing perceived social concerns with radical new products. RJR introduced Premier in test in September 1988 to address the perceived ETS issue. Premier

has been unsuccessful due to apparent taste and odor problems as well as its premium price and RJR pulled the product from test in March 1989. Nonetheless, media awareness and initial trial rates for Premier indicate that consumers may accept new product concepts provided they do not involve sacrificing basic cigarette characteristics such as taste.

PM-USA expects continued introduction of high-tech products throughout the plan period. These products could represent an opportunity to gain a competitive advantage, particularly against competitors who may be unable to match these initiatives due to constrained marketing budgets or limited R&D capabilities. RJR is currently testing Vantage Excel, which uses low sidestream paper technology and will test Chelsea, a female-oriented product which emits scented smoke.

MARKETING STRATEGY

PM-USA is confident that we have the strategies and resources to overcome these challenges and enhance our momentum in volume, share and profit growth. PM-USA will continue to implement the aggressive marketing strategy established in last year's plan. This strategy focuses on five essential priorities: (1) maximizing Marlboro's strength, (2) stabilizing other established full margin brands, (3) increasing our penetration of the price/value category, (4) pursuing technological innovation and (5) enhancing retail presence.

Marlboro

Marlboro's market share grew 1.3 share points to 24.9 percent of the industry in 1988. The brand's momentum has been sustained despite continued competitive initiatives aimed at the brand. Since the 1983 Federal Excise Tax increase, Marlboro has increased its volume by 19.1 billion units compared to a decline of nearly 140 billion units for all other full margin brands. This has enabled Marlboro to enhance its leadership position among major demographic groups, including men, women, whites, hispanics and young adults.

As in the past, Marlboro's growth is due to its ability to attract increasing share among new smokers as well as retain its smoker base as it ages. In 1988, Marlboro reached a 55.1 percent share among young adults, a gain of 3.0 share points over 1987. As a frame of reference, the next four largest brands, among young adults, lost a combined 2.4 share points. Marlboro's success can be attributed to its strong brand image as well as line extensions, such as Marlboro Lights and Menthol, which have extended the brand's demographic reach. PM-USA's investment in Marlboro's strong imagery has allowed it to compete successfully without widespread couponing, whereas in contrast, couponing rates in food stores for Winston and Camel represented 36 percent of their volume in 1988.

Protecting the Marlboro franchise and maintaining its growth remains a primary objective throughout the plan period. PM-USA will increase marketing and merchandising resources for Marlboro to achieve our objective of a 4.1 share point increase by 1993, reaching overall share and volume of 29.0 percent and 139.0 billion respectively. PM-USA will continue to use high impact advertising to maintain Marlboro's superior brand imagery and consumer promotions to reward consumer loyalty. A key objective of our retail programs is to heighten Marlboro's retail presence and provide sufficient space and in-store inventory to

reduce out-of-stocks. In addition, we will continue to use line extensions to broaden its demographic appeal and enhance Marlboro's ability to retain smokers as they age. For example, PM-USA plans to test Marlboro Ultra Lights in 1989. While Marlboro is not likely to be a springboard for new technology products, proven concepts provide further potential growth opportunities.

Other Full Margin Brands

In 1988, PM-USA's other full margin brands experienced market share declines ranging from 0.1 share point for Merit and Virginia Slims to 0.3 share points for Benson & Hedges. For B&H and Merit, this performance continues a trend which began with the doubling of the FET in 1983. Since that time B&H and Merit have declined 0.8 and 0.7 share points, respectively. Virginia Slims' modest decline followed a 19 year period of consistent growth and reflects the impact of new product introductions targeted at women, particularly Capri.

PM-USA's objective over the plan period is to stabilize the performance of these brands, which represent a substantial part of our brand portfolio. In total, B&H, Merit and Slims account for 10.8 share points and 27.4 percent of our total volume and their diverse demographic profiles and unique positioning broaden PM-USA's appeal beyond Marlboro. While additional support must be weighed against growth prospects, PM-USA will test a variety of options for the brands.

Virginia Slims, one of the industry's strongest brands, will continue to receive strong advertising and promotional support building on its new, more contemporary ad campaign. We will investigate new package designs including development of a recognizable Slims logo to make the brand more visible. Over the past three years, PM-USA has used line extensions -- 120's and Ultra Lights -- to expand Slims' demographic appeal. In 1989 we will test a Superslims line extension with low sidestream technology to both compete against Capri and address the social acceptability issue.

For B&H and Merit, PM-USA will test a combination of targeted marketing programs, regional price defenses and line extensions to supplement more traditional image building programs. Regional couponing and price promotion will be tested in markets where these brands are either underrepresented or have been impacted by price/value growth. Concentrated image building programs will be employed in the brands' strongest markets. In addition, line extensions employing new technologies represent a significant opportunity to bolster performance, particularly in light of Merit's high-tech heritage.

Price/Value Category

The price/value category was one of the industry's fastest growing segments in 1988. In total, price/value brands grew 0.9 share points in 1988, reaching 11.1 percent of the industry. The category's growth was fueled by branded generic products such as Cambridge, Doral, and Malibu as well as new product introductions like American Lights and Richland 20's.

PM-USA expects that the price/value category will continue to grow, however, the category's share in 1993 will be largely determined by the actions of competitors. Aggressive industry pricing will provide price conscious smokers a growing incentive to seek lower priced alternatives. This situation also makes

the repositioning of established brands such as Viceroy and the evolution of a third price tier more likely and could further accelerate the price/value category's growth to 25 percent of the industry. Should the third tier not materialize and no major full margin brands are repositioned, the category's growth would be in line with 1988, averaging 1.2 share points annually to 17.2 percent by 1993.

PM-USA has developed an offensive strategy to continue our momentum in the price/value category regardless of the actions of our competitors. Our current five year plan forecast calls for PM-USA's share of the category to increase an average of 3.3 percent annually with or without the development of a third tier. Most of PM-USA's price/value efforts will be focused on the branded generic segment, where our strategies include:

- Maintaining competitive pricing offers to consumers and capitalizing on opportunities against competitive products, including a third price tier.
- Continuing to enhance distribution, retail presence and depth of inventory.
- Capitalizing on growth opportunities with new products.
- Differentiating our products by providing consumers added value through superior taste and product quality.

PM-USA is also developing strategies to respond to a third price tier. Initially, PM-USA will ensure that Cambridge and Alpine remain competitive and we will also utilize our growing retail presence to make these brands highly visible to price/value consumers. However, if a significant third tier develops, PM-USA will be prepared to attain a representative category share by quickly responding with new price/value products.

Full Margin New Products

PM-USA's aggressive new product strategy provides an opportunity to achieve our marketing objectives by broadening our demographic profile, penetrating segments where PM-USA is underrepresented and gaining a competitive advantage by responding to changing consumer desires with superior products. Our new product efforts will include both high-technology concepts and more traditional products.

- High-technology products will provide smokers with discernible product benefits which address perceived concerns over social acceptability and position PM-USA to respond to possible government mandated product requirements. These new products will be combined with the superior imagery of our current brands to provide enhanced value versus competitive responses. A key objective in this strategy is to ensure that high-technology products deliver the same consumer satisfaction of traditional cigarettes. R&D is developing a number of concepts in conjunction with marketing and manufacturing which should be ready for test market early in the plan period.

- Line extensions will be utilized to broaden the appeal of existing brands and capitalize on growing industry categories such as ultra lights and box. We are currently considering line extensions for all of PM-USA's full margin

brands. Marlboro Ultra Lights will help Marlboro retain its smoker base by providing current low tar smokers seeking to switch down the tar spectrum with a Marlboro option. PM-USA is also developing B&H 85mm, Merit 100mm Box and a smaller circumference Superslims for test during the plan period. We will also test luxury/upscale products such as Cartier and Dunhill targeted toward affluent, upwardly mobile and young adult smokers.

Retail Strategy

An aggressive retail strategy is a key element in achieving our volume and market share objectives. PM-USA will enhance the availability and visibility of our brands with competitive merchandising plans and fixture programs which expand our contracted space in retail outlets and enhance our point-of-sale presence in all trade classes. Over the plan period, contracted carton rows will increase 23 percent, reaching 4.7 million. Nearly all of these incremental row gains will be used to accommodate new product introductions without sacrificing current inventory depth. In addition, we will review space allocated to Marlboro on existing carton fixtures and adjust to accommodate the brand's growth. We have developed new pack fixture goals for both supermarkets and convenience stores to capitalize on changing consumer purchasing patterns and utilize our strength in convenience-type stores, which represent the industry's fastest growing trade class.

Significant opportunities exist across most major trade classes. In food stores, a primary objective is to continue correcting PM-USA's long-standing underrepresentation in contracted space. Where appropriate, we will continue to expand the size of cigarette departments with aggressive fixture programs. Over the plan period, PM-USA carton fixtures at retail will increase approximately 80 percent to 27,600. Such programs are also designed to force RJR to defend their retail representation in carton outlets by installing larger fixtures, which allows us to achieve our row objectives without the cost of refixturing the retail universe. PM-USA will be satisfied with using RJR fixtures in major outlets as long as our objective of increased rack size is met. In addition, we will place 25,000 more supplemental freestanding racks over the next five years to accommodate the growth of Marlboro and price/value products. This will increase our total freestanding racks at retail to 75,000 by 1993.

The growing trend toward pack sales in supermarkets provides an opportunity to increase inventory and presence away from the main carton rack. Almost 30 percent of cigarette sales in supermarkets are pack purchases. By 1993, PM-USA will place front-end pack merchandisers in 20,000 stores compared to just 4,000 in 1988. These fixtures give our brands more visibility at the check-out lane, providing an opportunity to capitalize on last minute buying at the point of purchase.

In convenience stores, PM-USA has developed a new generation of pack hardware which increases display capabilities, point of sale presence and in-store inventories. For example, PM-USA's new counter display offers 30 display opportunities compared to only 18 on our largest fixture just two years ago. Over the plan period, placement of pack displays will increase by 10,000 to 103,000, reflecting the continued growth of the convenience trade class. PM-USA will continue to upgrade current contracts to larger fixtures wherever possible

and identify opportunities for additional placements. We will also work to install a second PM-USA pack display in accounts where feasible to facilitate new product introductions and maintain price/value presence. An important element in expanding in-store inventories is the continued placement of overhead merchandisers in typical pack outlets. PM-USA is projected to place these fixtures in over 23,000 more accounts over the next five years, building on the 47,600 accounts which presently have them.

In late 1988, PM-USA restructured and expanded our sales force to implement our brand programs and accommodate accelerated new product introductions. Over four hundred sales reps and nearly seven hundred part-time merchandisers were added. This expansion positions PM-USA to increase the frequency and quality of our sales calls and will allow the sales force to more effectively identify and develop programs which satisfy PM-USA's marketing objectives and respond to the needs of individual accounts.

SOCIOPOLITICAL STRATEGY

PM-USA's ability to implement our marketing strategy and successfully meet our Five Year Plan objectives is dependent on protecting industry volume by aggressively answering attacks from anti-smoking advocates and protecting the rights of consumers and manufacturers. This task has become more challenging as social perceptions of smoking change. Anti-smoking forces have shifted the focus of smoking issues away from the smoker to the non-smoker, and used the ETS issue to spark smoking restrictions, thereby increasing the social pressures on smokers. In addition, recent calls for studies into the alleged social cost of smoking seek to position smokers as burdens on society to justify excise tax increases and other restrictive measures. If unchallenged, these attacks will fuel more anti-smoking legislation than the industry has experienced over the last five years.

PM-USA has developed strategies to deal with these threats and address social perceptions of smoking. Over the plan period, we will maintain and expand our principal programs which target three groups whose decisions and actions ultimately determine the long-term viability of the cigarette industry -- political decision makers, smokers and non-smokers and the mass media.

A large part of PM-USA's efforts will be directed at the state and local level, where anti-smoking legislation is being introduced at an accelerated rate. PM-USA is adopting a strategy which combines defeating new anti-smoking proposals with introducing legislation to reverse existing regulations and to otherwise prevent discrimination against smokers. Utilizing our corporate affairs regional network, we will work for legislation to prevent discrimination of smokers in hiring and promotion, require smoking areas in all public places and the work place, encourage local governments not to levy cigarette taxes and not to pass restrictive smoking and advertising/sampling legislation. Over the plan period, we will continue to expand our ability to communicate with smokers through vehicles like <u>Philip Morris Magazine</u> and <u>Smoker Newsletters</u>. We will also continue our support for smokers who are becoming a more organized and vocal constituency poised to present their views to decision makers as issues arise.

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On the ETS issue, PM-USA will continue its leadership in investigating the scientific merit of claims that ETS harms non-smokers. PM-USA will also help disseminate accurate information about ETS to the media, politicians, labor unions and other decision makers. Our objective is to make persuasive arguments that accommodation, rather than smoking bans, is the appropriate answer. Over the plan period, we will also correct misleading information and distribute accurate information to reverse preconceived notions about the social cost of smoking.

Other significant concerns which must be addressed during the plan period include possible marketing restrictions and government mandated product regulations. Over the plan period, PM-USA will rely on public and political concern over First Amendment rights and enlist the support of related industries to prevent any additional restrictions on advertising, sampling and promotions. In addition, over the plan period, we will work to ensure that no punitive compulsory requirements become law.

OPERATIONS STRATEGY

Our manufacturing philosophy places a premium on quality, flexibility and innovation. PM-USA's primary objective for manufacturing is to enhance cost efficiencies while effectively meeting our growing production requirements for both domestic and export markets. Over the next five years, production requirements are forecasted to increase 7.3 percent to 317.2 billion units. As discussed previously, accelerated new product programs will provide much of this growth. Therefore, along with this growth comes the need for increased flexibility as the number of packings produced will expand well beyond the 231 currently manufactured in our facilities. In this environment, PM-USA has targeted an increase in composite cigarettes per labor hour of 4,400 cigarettes per minute reaching 21,600 by 1993. This increase, along with productivity savings in materials and overhead, will contribute to an overall 34¢ per thousand decrease in constant dollar manufacturing costs which will provide a cumulative constant dollar savings of $350 million over the plan period.

Our ability to achieve these objectives rests primarily in our continued investment in new assets and technologies. In 1986, PM-USA initiated a factory modernization program to increase capacity and improve productivity. With Bay 2 at the Manufacturing Center complete, PM-USA is preparing for the next step of the program. Over the plan period, PM-USA manufacturing is forecasting capital expenditures of $1.1 billion, 75 percent of which is directed at modernization and expansion. When complete, this program will expand our total manufacturing capacity by 12 percent without building additional facilities and provide labor savings of 1,184 people. The reduction in people will result from both increases in machine speeds and efficiency improvements, which will reach 77.1 percent by 1993.

PM-USA is also taking steps to assure that productivity and capacity enhancements are attained without sacrificing quality. Consistent product quality builds brand loyalty and reinforces consumers' purchase decisions, particularly in an environment filled with lower price alternatives. PM-USA lowered critical defects by 20 percent in 1988 while maintaining high relative quality compared to competitors. This improvement is reflected in a declining

level of consumer complaints, which are at the lowest level since we began tracking them. Over the plan period, PM-USA is investing in pro-active programs that maintain and improve the total scope of product quality, including taste, consistency, and packaging.

A cornerstone of PM-USA's quality strategy is to ensure an adequate supply of high quality domestic leaf tobacco. To accommodate our growing worldwide volume and compensate for reduced offshore purchases and government pool stocks, PM-USA is increasing leaf durations by two months, back to historical levels of 21 months for thins and 27 months for bodied tobacco. Additional flexibility will be provided through internal efforts to develop blend alternatives and maintain blends to optimize leaf utilization. In addition, PM-USA will use our strong relationship with the U.S. agricultural community to promote technically innovative and cost effective farming methods which will minimize our cash outlays for leaf.

Research & Development

Aggressive and innovative R&D programs are essential to maintain our pre-eminent position in the cigarette industry over the next five years. Aside from our ongoing work on conventional products, significant developmental emphasis will be placed on concepts which address changing perceptions of smoking such as lowered nicotine, lowered sidestream and alternative smoking articles. Some of these concepts will be ready for test market in the early stages of the plan period. PM-USA will also continue to develop conventional products which expand the appeal of our brands such as Marlboro Ultra Lights and B&H 85mm.

PM-USA considers our R&D spending an investment for both the domestic and international businesses. A major effort will be made to tailor new products and processes to the individual worldwide marketplaces. Another important objective for R&D is to leverage technology in our manufacturing processes to promote cost efficiencies, material utilization and manufacturing flexibility. For example, R&D is developing means to utilize advanced optical scanning technology which will allow PM-USA to install higher speed equipment without sacrificing product quality.

In addition, we will continue to provide a broad foundation of basic research that will generate new product concepts for the future. These new concepts are essential if we are to maintain a steady stream of both traditional and technologically advanced products beyond the horizon of our Five Year Plan.

SUMMARY

PM-USA's strategy of continued investment in the cigarette industry resulted in accelerated share growth of 1.5 share points to 39.3 percent of the industry in 1988. This performance indicates that PM-USA's target of a 50 percent share in the 1990's is well within our reach. To achieve this objective, PM-USA will increase our investment in advertising and promotion to support our superior brand images as well as introduce innovative new products. We will also continue to enhance retail presence to make our products the most visible brands in the industry. These efforts will result in increased penetration of all major industry categories as well as increased operating income and cash flow. We are confident that our objectives, even though aggressive, are attainable and with continued investment will be achieved.

PM-USA FIVE YEAR PLAN INCOME FORECAST
(Dollar Amounts in Millions)

	Actual* 1983	Actual 1988	1989	1990	1991	1992	1993	1988-1993 C.A.G.
Unit Volume (Billions)	204.7	221.7	223.4	227.1	231.0	234.5	237.6	
Operating Revenues	$5,519.9	$8,500.6	$9,543.9	$10,688.8	$11,853.6	$13,008.5	$14,331.3	11.0%
Variable Cost	$2,971.1	$3,258.9	$3,378.5	$ 3,673.5	$ 3,998.3	$ 4,198.0	$ 4,477.2	6.6%
Shipping	63.0	67.4	72.5	77.7	82.9	88.2	94.0	6.9%
LIFO Adjustment	72.3	27.4	(2.7)	44.6	42.9	51.3	54.5	14.7%
Fixed Cost	344.7	439.7	484.3	508.8	530.8	562.0	588.2	6.0%
Available Profit	$2,068.8	$4,707.2	$5,611.3	$ 6,384.2	$ 7,198.7	$ 8,109.0	$ 9,117.4	14.1%
% of Sales	37.5%	55.4%	58.8%	59.7%	60.7%	62.3%	63.6%	
Marketing	$ 641.0	$1,386.8	$1,638.6	$ 1,884.0	$ 2,102.0	$ 2,350.0	$ 2,595.0	13.4%
Corporate Affairs	4.7	81.6	110.1	122.8	137.2	141.2	157.5	14.1%
General & Adminstrative	44.0	100.5	102.5	108.8	115.9	123.1	131.0	5.4%
Research & Development	41.9	62.5	65.2	73.3	80.6	87.9	95.8	8.9%
Other Deductions/(Income)	0.3	(10.9)	(10.8)	(10.8)	(11.1)	(11.6)	(12.0)	
Income From Operation	$1,336.9	$3,086.7	$3,705.7	$ 4,206.1	$ 4,774.1	$ 5,418.4	$ 6,150.1	
% of Sales	24.2%	36.3%	38.8%	39.4%	40.3%	41.7%	42.9%	
Change Over Prior Years	21.4%	13.7%	20.1%	13.5%	13.5%	13.5%	13.5%	14.8%
Corporate Assessments	N/A	$ 95.7	$ 54.8	$ 51.0	$ 49.9	$ 54.4	$ 59.3	
Earnings Before Income Tax	$1,336.9	$2,991.0	$3,650.9	$4,155.1	$4,724.2	$5,364.0	$6,090.8	
Income Tax	632.2	1,054.2	1,382.7	1,573.7	1,789.2	2,041.0	2,317.6	
After-Tax Income	$ 704.7	$1,936.8	$2,268.2	$2,581.4	$2,935.0	$3,323.0	$3,773.2	
Change Over Prior Year	19.6%	38.1%	17.1%	13.8%	13.7%	13.2%	13.5%	14.3%

* 1983 has not been restated to post spin-off format and does not include Overseas Military units.

BALANCE SHEET FORECAST
DECEMBER 31, 1983, 1988 - 1993
(Dollar Amounts in Millions)

	Actual 1983	Actual 1988	1989	1990	1991	1992	1993
ASSETS:							
Cash	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1
Receivables	217.2	297.9	380.3	405.6	425.8	446.2	466.4
Inventories at LIFO	1,611.7	1,548.7	1,923.5	2,084.6	2,172.3	2,208.1	2,239.2
Prepaid Expenses	21.5	31.6	34.9	36.6	38.4	40.1	41.7
Total Current Assets	$ 1,850.5	$ 1,878.3	$ 2,338.8	$ 2,526.9	$ 2,636.6	$ 2,694.5	$ 2,747.4
Net Property, Plant & Equipment	$ 1,656.8	$ 1,789.4	$ 1,966.5	$ 2,046.1	$ 2,068.4	$ 2,040.4	$ 1,969.2
Other Assets	0.2	1.3	1.3	1.3	1.3	1.3	1.3
Total Assets	$ 3,507.5	$ 3,669.0	$ 4,306.6	$ 4,574.3	$ 4,706.3	$ 4,736.2	$ 4,717.9
LIABILITIES & CAPITAL:							
Current Portion Long-Term Debt	$ -	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1	$ 0.1
Accounts Payable & Accrued Liabilities	165.8	558.9	414.1	449.7	492.3	535.1	577.5
Federal Excise & Other Taxes	140.4	101.8	62.2	69.5	69.9	70.1	70.9
Total Current Liabilities	$ 306.2	$ 660.8	$ 476.4	$ 519.3	$ 562.3	$ 605.3	$ 648.5
Other Liabilities	$ 10.0	$ 19.9	$ 19.9	$ 19.3	$ 19.3	$ 19.3	$ 19.3
Net Income-Current Year	704.7	1,936.8	2,268.2	2,581.4	2,935.0	3,323.0	3,773.2
Intra-Company Balance	2,486.6	1,051.5	1,542.1	1,454.3	1,189.7	788.6	276.9
Total Liabilities & Captial	$ 3,507.5	$ 3,669.0	$ 4,306.6	$ 4,574.3	$ 4,706.3	$ 4,736.2	$ 4,717.9

FUNDS FLOW ANALYSIS
FOR YEARS 1988-1993
(Dollar Amounts in Millions)

	Actual 1988	1989	1990	1991	1992	1993
AFTER TAX CASH FLOWS FROM OPERATIONS						
Net Earnings	$1,908.2	$2,294.7	$2,605.2	$2,957.2	$3,356.5	$3,809.8
Depreciation	153.7	176.4	219.6	240.9	258.7	267.8
Cash Flows from Operations	$2,061.9	$2,471.1	$2,284.8	$3,198.1	$3,615.2	$4,077.6
Changes in Assets & Liabilities	$ 412.9	$ (644.9)	$ (145.8)	$ (66.7)	$ (14.9)	$ (9.8)
Net Cash Flows from Operating Activities	$2,474.8	$1,826.2	$2,679.0	$3,131.4	$3,600.3	$4,067.8
Cash Flows from Investing Activities						
Capital Expenditures	$ (366.3)	$ (359.7)	$ (302.3)	$ (266.4)	$ (234.0)	$ (200.0)
Disposals - Fixed Assets/ Other	10.3	6.2	3.1	3.2	3.3	3.4
Net Cash Flows - Investing Activities	$ (356.0)	$ (353.5)	$ (299.2)	$ (263.2)	$ (230.7)	$ (196.6)
Cash Flows - Financing Activities						
Net Cash Flows - Long Term Debt	$ (1.2)	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Net Cash Flow - Total Year	$2,117.6	$1,472.7	$2,379.8	$2,868.2	$3,369.6	$3,871.2

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PHILIP MORRIS

Philip Morris International

PHILIP MORRIS INTERNATIONAL

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of Philip Morris International's forecasted industry environment.

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PM INTERNATIONAL 1989-1993 BUSINESS PLAN

In 1988 PMI turned in its best performance ever. Unit Volume reached a new level of 335 billion units. We gained market share worldwide, posting gains in eighteen of our top twenty markets. We set records for Income from Operations, Pretax and Net Earnings. Return on Assets improved to 11.5%, its highest level in over 20 years.

During the Plan period 1989-93 PMI intends to build on its current momentum. Our objectives are to achieve:

a) a compound annual growth rate of 4% in unit volume and continued gains in market share.
b) a minimum 15% growth rate in Income from Operations.
c) further improvement in Return on Assets.

Objective a) has been lowered from 5% in previous Plans to 4%, due to the absence of major new market openings during the Plan period. The opening of Turkey, Japan and Taiwan to foreign competition in recent years resulted in significant incremental volume in addition to growth from the existing business. Similar market openings are not foreseen between now and 1993. In addition, political and economic conditions have caused us to lower our growth projections in certain large markets. The 4% overall rate disguises a higher rate of growth in our "good" markets - those which have good margins and predictable earnings. Volume in these markets grows 5.2% annually. Diminishing this is a lower growth rate in our "poor" markets - those which suffer from economic or political instability, low margins and unpredictable earnings. Volume in these markets grows 1.2% annually.

Financial highlights of the Plan are as follows:

	Actual		O.B.	Plan				CAG %
	1987	1988	1989	1990	1991	1992	1993	88-93
Cigarette Units (bil)	321	335	348	363	377	392	408	4
Income from Operations ($ mil)	582	774	1,031	1,185	1,329	1,488	1,666	17
Return on Assets (%)	8.9	11.5	18.5	20.0	21.1	22.4	23.6	

Unit Volume will increase by 73 billion units or 22% to 408 billion by 1993.

Income from Operations will rise by nearly $900 million to more than $1.6 billion. The largest increase comes in 1989, when an absence of provisions affects the comparison. Substantial reserves were made in 1988 to take account of possible adverse developments in unstable economies where we do business. This had the effect of lowering our 1988 reported earnings. As a result of these provisions we enter the Plan period with limited downside exposure on our balance sheet.

Return on Assets will improve primarily due to the higher income. Our asset base grows 15% over the Plan period to $3.8 billion, mainly due to working capital increases. Investment in fixed assets increases in line with previous Plans. We do not foresee major new capital expenditures. However, we will likely be required to establish local manufacturing operations in Turkey during the Plan period. Capital expenditures relating to this project are not included in the Plan, since the structure and capitalization of the venture have yet to be negotiated.

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This Plan consists of four sections:

I. A review of our performance in 1988
II. The 1989-93 Plan
III. A discussion of major markets
IV. Other issues

I. REVIEW OF 1988

In 1988, PMI achieved record sales and earnings.

o Volume was up 4.4% versus 1987.

- U.S. Export volume increased 13.2% to 69 billion units, a new record. Continued rapid growth in our Asian markets more than offset declines in markets such as Turkey and Saudi Arabia.

- Licensee volume was up 4.7% to 54 billion. This reflected growth in Iberia and Eastern Europe, and a recovery in our Philippine business.

- In domestic markets supplied by our foreign manufacturing operations, which is the bulk of our volume, sales were up 1.8% to 212 billion units. In this case, continued strong gains in the EEC were partly offset by declines in Canada and Latin America.

o These gains resulted in widespread increases in market share. Share was up in eighteen of our top twenty markets including Germany, Italy, France, Switzerland and Japan. The declines were due to a competitor-initiated price war in Saudi Arabia and government actions in Turkey, where a discriminatory pricing policy vis-a-vis imports resulted in a volume loss for our brands.

o All major brand families gained versus 1987. Marlboro family volume grew 6.7% to 167 billion, with Marlboro Lights up 43% to 14 billion units - both ahead of last year's Plan. Marlboro grew particularly well in the EEC and worldwide Duty Free markets. The Philip Morris family was up 3.0% to 24 billion units, Merit grew 20% to 8.2 billion, and Parliament increased 32% to 7 billion units. Collectively, our Liggett trademarks - Chesterfield, L&M and Lark - increased by 2.7% to 28 billion units, with Lark in particular gaining in Japan. Thirty seven new launches in our top markets added 3.9 billion units to our volume.

o Improved pricing combined with the higher volume to produce record earnings. Price increases added $168 million to our income in addition to $183 million contributed by volume gains. Partly offsetting this were higher DME and provisions - relating mainly to our Latin American operations - which together amounted to $223 million. The result was an 18% increase in income excluding the impact of currency.

o Currency movements added another $88 million to our income. For the third consecutive year currency movements had a beneficial impact on PMI's earnings. This was due to the revaluation of all major European currencies, as well as the Yen and the New Taiwan dollar, against the U.S. dollar.

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Our Performance Compared to Our Competitors

In 1988, PMI increased its share of the international cigarette market from 7.1% to an estimated 7.3%. Looking at our top twenty markets, we gained share in eighteen, RJR in twelve, BAT in five, and RI in five. PMI's worldwide volume gain exceeded that of all of these competitors combined, although RJR recorded a higher percentage gain.

	1988 Volume (bil)	Change vs 1987 Units (bil)	%
PMI	335	14	4.4
RJR	108	9	9.0
RI	144	(1)	(0.9)
BAT	464	(13)	(2.7)

While we view the three preceding companies as our principal competition in the international cigarette market, state monopolies are the major competitors in the important markets of Japan, France, Italy, Spain, Turkey, Taiwan and Korea. One monopoly - Japan Tobacco Inc - is larger than either RI or RJR. PMI gained share at the expense of every one of these monopolies except Turkey's Tekel during 1988.

Our Performance Compared to Our Earlier Plans

Looking at our prior Plans for 1988, our unit volume of 335 billion units exceeded the 1986 and 1987 objectives and achieved the 1988 forecast. Compared with the 1986 Plan, our performance exceeded our forecasts in Japan, Taiwan, China, Turkey, EEC Duty Free and Canada, following our merger with Rothmans there. We did not reach our volume objectives in Brazil, Argentina, Mexico, Spain/Canaries and France. Although we did not grow as quickly as we had forecasted in these markets, we continued to gain both volume and share, except in Brazil and Argentina.

Income from Operations, at $774 million, exceeded all previous Plans for 1988. This was due to the higher volume and a better mix of business - that is above-Plan performance in our "good" markets more than offsetting below-forecast results in our "poor" markets. The currency gain versus last year's Plan was largely offset by provisions.

Return on Assets, at 11.5%, was in line with the 1986 Plan objective, and exceeded the 1987 and 1988 Plan targets.

II. 1989-93 PLAN

At PMI we plan for three years and extrapolate the last two years. While we operate in over 170 countries and territories, twenty markets account for over 50% of volume and over 90% of Income from Operations. Our volume and income plans for these "top markets", ranked according to earnings growth over the Plan period, are summarized below.

	Unit Volume (bil)			Income from Operations ($ mil)		
Market	1988	1991	Change	1988	1991	Change
Japan	23	29	6	68	194	126
West Germany	32	38	6	181	282	101
France	20	25	5	26	86	60
Turkey	10	12	2	63	108	45
Italy	34	37	3	157	194	37
EEC Duty Free	9	8	(1)	65	101	36
Australia	11	11	0	28	55	27
Latin America Exports	4	4	0	29	50	21
Duty Free South	2	3	1	21	41	20
Taiwan	3	4	1	34	52	18
Hong Kong	3	3	0	30	45	15
Netherlands	3	4	1	7	20	13
Belgium/Luxembourg	3	4	1	3	12	9
USA Duty Free	1	1	0	11	18	7
Finland	5	5	0	30	35	5
Switzerland	6	7	1	58	61	3
Kuwait	1	1	0	14	13	(1)
China	5	5	0	21	19	(2)
Spain	7	13	6	28	24	(4)
Saudi Arabia	5	6	1	41	34	(7)
Total Top 20	187	220	33	915	1,444	529
All Other	148	157	9	69	89	20
Total PMI	335	377	42	984	1,533	549
Corporate Assessments				(210)	(204)	6
Consolidated Income from Operations				774	1,329	555
Top 20 - % of total	56%	58%		93%	94%	

The most significant development will be Japan's emergence as our greatest source of incremental income. West Germany will remain our leading income producer and become our largest volume market, while France will become a major income contributor for the first time.

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III. A DISCUSSION OF MAJOR MARKETS

Our top five markets will account for 56% of Income from Operations in 1991 and 67% of incremental income over the Plan period. They will be discussed in detail.

Japan

	1988	1989	1990	1991	% CAG
Industry volume (bil)	306.7	303.6	300.6	297.6	(1.0)
Market share (%)	7.5	8.3	9.0	9.6	+2.1 pts
Unit volume (bil)	23.1	25.5	27.4	29.0	7.9
Share of imports (%)	58.5	60.3	60.7	60.8	2.3 pts
Import share of market (%)	11.6	12.8	13.8	14.8	3.2
Income from operations ($ mil)	68	157	188	194	36.5

In Japan the key issue we face is how to increase the rate of growth of the import segment. This will be partly dependent on how the industry uses the gains from tax reform, which will be implemented on April 1, 1989 and could add as much as $85 million to PMI's Income from Operations on an annual basis.

Our plan is to continue heavy investment spending on marketing despite the absence of a price increase during the Plan period, in order to ensure continued volume and share gains. This will constrain income growth to about 11% annually between 1989 and 1991.

Our brand plans include continued strong support for Lark in the Y250 segment and Parliament in the Y280 segment. We will expand our sales force coverage to encompass the total retail universe in 1989, and will maximize the use of television while still available, emphasizing high quality creative and longer commercials. In preparation for the expected television ban, we will invest in large permanent billboards, upgrade print advertising, expand FM radio coverage and increase the number of cinemas under exclusive contract.

We have recently launched Merit at Y250, and plan to make this our leading low-tar entry. In the Y240 segment we will launch reformulated versions of both Marlboro Red and Lights - Red with a charcoal filter in soft pack and box, and Lights - which already has a charcoal filter - in a box packing.

Despite our strength in the upper price segments, we remain under-represented in the mainstream Y220 segment. This accounts for approximately 70% of the market and is dominated by local brands. We plan to establish a meaningful presence there. We will improve the creative for Philip Morris Superlights- our main entry - and have introduced a box packing for the brand. We plan to launch Chesterfield in 1990 to strengthen our position, and Alpine Lights as a freestanding menthol brand - also in 1990. In the Y200 segment, we will launch a box version of L&M to reinforce our position as the leading foreign supplier, and as a precaution against intensified price competition among imports.

West Germany

	1988	1989	1990	1991	% CAG
Industry volume (bil)	117.0	116.2	115.2	115.2	(0.5)
Market share (%)	27.6	29.7	31.5	33.2	5.6 pts
Unit volume (bil)	31.9	34.5	36.2	38.2	6.2
Income from operations ($ mil)	181.4	213.8	235.7	282.1	15.9

In West Germany, we plan to strengthen our position as the market leader and increase profitability primarily through volume and share growth. Price increases will be limited to small increments to preserve industry volume and avoid the risk of a price war.

Marlboro will continue to account for the majority of our volume gains. We will further develop the current successful marketing mix aimed at young adults, maintain the high visibility and quality of the Marlboro Country Campaign and extend promotions into low share areas, specifically in the north of the country. We will continue to build Marlboro line extensions, particularly Lights, which is growing well. We plan to increase sampling and switch-selling programs for this brand and to expand availability in vending and the food trade.

To grow Philip Morris we will refine the "Human Space" campaign, making greater use of models in the creative, and will concentrate advertising on print and outdoor. We will increase vending distribution and develop the direct mail marketing campaign created for the 1988 launch of Philip Morris Ultra. We recently launched Philip Morris KS box (Gold Pack) as a prestige brand positioned against Benson & Hedges. This will be targeted at those consumers seeking luxury and elegance.

We recently reacquired the rights to Chesterfield and plan to extend distribution nationally, promoting the brand as a full-flavor American-blend alternative to Camel. We will continue to support L&M as a price brand, to be ready in the event of a price war.

A tax increase of DM 0.10/pack is scheduled for May 1989. In anticipation of this, we implemented a price increase of DM 0.20/pack in 1988. We plan to absorb the tax increase in May and raise prices by DM 0.10/pack in November 1989, which will more than restore our margins to pre-November 1988 levels. A further DM 0.20/pack increase is scheduled for August 1991. To increase future profitability we will lobby the government to raise the specific tax element beyond 40%.

France

	1988	1989	1990	1991	% CAG
Industry volume (bil)	93.0	93.0	92.0	90.5	(0.9)
Market share (%)	21.2	23.5	25.6	27.6	6.4 pts
Unit volume (bil)	20.2	21.8	23.6	25.0	7.3
Income from operations ($ mil)	25.5	48.0	63.0	86.0	50.0

Despite a 20%+ market share and a ranking as one of PMI's top volume markets, France was a minor profit contributor until 1988. Price increases granted during the year resulted in a sixfold increase in income to over $25 million. Nevertheless margins, at around $6.50/000, remain nearly 40% below our EEC average. Our objectives are to grow volume and market share and improve margins by ensuring that the government maintains its commitment to free prices in 1989. Thereafter we plan to achieve price increases of 9.5% per annum.

In order to achieve selling price increases, we will lobby the Ministry of Finance and the Ministry of Budgets, in cooperation with the EEC Commission and SEITA. We will use the foreign press to publicize France's contravention of EEC practices, and the European Court of Justice's ruling to this effect.

To grow volume and share we will use our recently increased allotment of the advertising quota to expand Marlboro Country and Motorsport advertising. We will increase awareness of the Philip Morris brand family outside of Paris and in the southeast by shifting media weight to national and regional magazines. We will continue to position PM Filter Kings and Chesterfield - which are both growing well - against Camel, and Fortuna as a tactical brand against potential low-price competition. In addition, we will strive to have our share of the advertising quota increased to at least our market share.

The sales force will be expanded by 39 people in 1989 to improve our coverage of secondary outlets, particularly in regional areas.

Italy

	1988	1989	1990	1991	% CAG
Industry volume (bil)	97.6	100.7	100.0	99.0	0.5
Market share (%)	34.1	34.6	35.8	36.9	2.8 pts
Unit volume (bil)	33.5	34.8	35.8	36.5	2.9
Income from operations ($ mil)	157.0	153.5	170.4	194.3	7.4

In Italy, PM is the leading foreign supplier and we account for 82% of the foreign segment. We have a longstanding relationship with Monital, the state monopoly, which manufactures some of our volume under license and distributes our products. We have been able to obtain regular price increases. There has been no increase in tax incidence in the market for over 20 years.

Our main objective is to increase our share of the foreign segment and the total market, while maintaining our relationship with Monital. We will use the licensee production level as a bargaining tool to soften the impact of Monital's declining volume and to avoid an increase in the price gap between MS and our brands, which would threaten our profitability. Unit profitability is nevertheless forecast to decline in 1989 due to a devaluation of the Lira against our manufacturing currencies, the DM and the Guilder.

Advertising is banned in this market. For this reason, our brand plans emphasize promotional activities. For Marlboro, emphasis will remain on both Marlboro Country and Marlboro Motorsport promotions. For motorsport, we will maintain

signage exclusivity at race tracks. We will also continue to exploit the Ferrari sponsorship. To capitalize on the renewed growth in Merit, we plan to reinforce its image as a young and modern brand, focussing our activities around the sailing diversification. For Philip Morris, we will exploit the brand's image of lightness and prestige with sampling and information campaigns and "corporate" sponsorship activities. Chesterfield is performing well and we will continue to target the brand against Camel; and for Multifilter we will use the new bevelled-edge pack to enhance its image of quality and prestige. To further expand volume we will introduce Ultra Light 100s line extensions for Merit, Philip Morris and Multifilter.

Turkey

	1988	1989	1990	1991	% CAG
Industry volume (bil)	69.0	71.0	73.0	75.0	2.8
Market share (%)	12.4	12.8	13.4	13.6	1.2 pts
Unit volume (bil) - domestic	8.6	9.1	9.8	10.3	6.0
- duty free	1.5	1.5	1.7	1.9	8.2
- total	10.1	10.6	11.5	12.2	6.3
Income from operations ($ mil)	63.3	78.2	99.1	108.3	19.6

Turkey is a market which represents great potential but also uncertainty for PMI. The government plans to disband the monopoly Tekel and sell its factories to the private sector. It is requiring foreign suppliers to establish local manufacturing facilities if they wish to continue to compete in the domestic market. Imports will be banned at some point thereafter. Our objective is to negotiate successfully a joint-venture manufacturing agreement to include the country's biggest factory and its leading brand, "Maltepe", while maintaining the more profitable export business for as long as possible.

We plan to sign a joint-venture agreement in which PM has a 65% equity stake and control, Tekel 15% and the local Sabanci industrial group 20%. We will negotiate continued importation during the manufacturing startup, retail pricing freedom, a non-discriminatory tax structure and a license for Tekel's Maltepe (39 billion units, 50% S.O.M.) at a reasonable royalty. We expect to commence local manufacture of Marlboro from imported cut filler in 1990 or 1991 and to begin work on a new 20-billion-unit-capacity facility for blended products within the Maltepe factory. PM's share of the capital expenditures associated with this project could reach $200 million, of which $60 million could take place during the Plan period. Much of this will be contributed in the form of quality reconditioned machinery. We foresee a three-year phase-in period for the manufacture of our brands.

At the same time we will improve our retail presence by doubling the field sales force to 180 by 1991. Brand plans include advertising Marlboro widely in all available media and adapting the Japanese "American Blue" campaign for Parliament. We will launch Chesterfield in 1990, positioned against Camel, which sells at a price below Marlboro.

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Other Top Markets

Other markets which contribute materially to our income growth are Australia, where better pricing and operating efficiencies will add $27 million to Income from Operations by 1991; Taiwan, where volume and pricing will increase income by $18 million; and our Duty Free businesses in the EEC, Asia and Latin America, which collectively add $77 million to our earnings, due mainly to better pricing.

Markets such as Switzerland, Hong Kong and Finland will continue to be big income producers, though they are expected to grow at slower rates than historically. Belgium/Luxembourg and the Netherlands will become material income producers for the first time. Together they will contribute $22 million to 1991 Income from Operations.

Top markets which show income declines are China, where lower duty-free allowances will curtail our income; Saudi Arabia, where absorption of a duty increase and price competition will erode margins; Kuwait, due to price competition and lack of industry volume growth; and Spain, where increased income from the rapid growth of Marlboro will be insufficient to compensate for the loss of tobacco and supply income on the Monopoly's brand, Fortuna.

Problem Markets

Three of our markets have failed to match Plan expectations. One - Saudi Arabia - is a top twenty market. The others are the U.K. and Brazil. In addition, Korea is a new market which represents a challenge at this time. The following is a summary of our situation and plans for each.

In Saudi Arabia we have experienced erratic volume and declining income for the past three years. A duty increase in 1985, the exodus of expatriate workers, and the oil recession have led to a market contraction, downtrading and price competition. Marlboro has held up well in the declining premium-price segment, losing only 2.6 share points since 1986. But our low-price entry - Visa - has not performed as well as some competitive products. One low-price brand - RJR's Gold Coast - has enjoyed considerable success and now accounts for 20% of industry volume.

The competitive situation is complicated by an anticipated duty increase from 30% to 50% of CIF price, which will likely occur in 1989, and the expected increase in the minimum specific tax from SR 240 to SR 400 per case. This will cause a realignment of the different price categories.

Passing on the duty increase to consumers would lead to further industry decline and market gains for Gold Coast. Conversely, absorption of the increase would preserve industry volume but lower our profits. It would, however, lead to a narrowing of the price gap between Marlboro and Gold Coast, since the specific tax increase will force up the prices of cheaper products. This would lead to some recovery of Marlboro volume and a decline for Gold Coast.

We have resolved to absorb the duty increase when it occurs, in conjunction with our Saudi distributor. We have already dropped the price of Visa and L&M (ex-USA) to be more competitive with Gold Coast and will launch Visa Lights and L&M Lights to strengthen our position in the low-price segment. Marlboro's retail price will remain unchanged. The strategy of concentrating on volume and sacrificing profits will result in lower income over the Plan period, but will leave us well placed if and when margins return to historic levels.

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In the U.K., our situation is essentially unchanged. Our market share remains around 5%, neither Marlboro nor Raffles has momentum, new launches have failed to generate significant incremental volume, and operating losses attributable to the business continue at a level of approximately $25 million annually. There are no trends in the market which suggest that a shift to our brands is likely and we will therefore remain below our breakeven point. In order to improve our situation, we must restructure our business. We are currently exploring alternatives to accomplish this.

In Brazil, we have not met our Plan targets and during 1988 our situation even deteriorated. The inflation rate in the country exceeded 900%, purchasing power eroded and downtrading was widespread. Our market share declined slightly to 8.0% and operating losses reached $9 million, versus a forecast loss of $2 million. Exports to our EEMA and Asia Regions increased from 1.3 billion units to 3.1 billion, which helped finance the domestic operation, as well as providing low-cost products for markets such as Lebanon.

In Brazil we face a competitor, BAT, which controls almost 80% of the market. We cannot afford to launch new brands, take initiatives with the trade, or in any way improve our competitive stance. Nevertheless, this is the third largest market in the non-Communist world, and one which represents considerable potential. We believe we must restructure our operation if we are ever to participate profitably in the market, and are currently examining our options. In the event that we cannot find a solution, we may recommend closing the operation.

The Korean market opened to foreign competition in July 1988 and the startup has been difficult. There has been discrimination against foreign cigarettes by the monopoly KOMOCO, our signs have been defaced and retailers harassed, and there have been widespread press attacks on U.S. cigarettes. The foreign segment reached a share of only 2.3% for the six months the market was open. While we accounted for more than one-third of this, our operating losses totalled $12.1 million.

Both Marlboro Lights and Parliament are performing reasonably well. However, there are indications that the current mix of foreign products does not suit the taste of Korean consumers, who tend to favor lower tar and nicotine products and have demonstrated a preference for premium-priced imports such as RJR's YSL. We recently launched Lark Deluxe Milds and will roll out Virginia Slims Lights, which is showing promise in test market. We will launch Merit Lights in July 1989.

Our marketing efforts will concentrate on direct consumer contact and localized promotions. In addition, we will institute corporate affairs efforts to resolve differences over interpretations of the record of understanding between the U.S. and Korean governments, to inform retailers of their rights, and to develop a positive perception of PM Korea as a member of the community. We have taken steps to contain our losses, and intend to energetically pursue new initiatives in order to establish a profitable presence in the market.

New Market Opportunities

We do not anticipate any major market openings during the Plan period. However, four markets represent largely untapped potential. These are: Indonesia, Thailand, the U.S.S.R., and the domestic Chinese market.

Indonesia is a 130-billion-unit, mainly kretek (clove-flavored) market. Marlboro is manufactured under license and the brand is growing rapidly, though its market share is still only 0.3%. We increased resources behind the brand in 1988 and it responded with a 37% sales gain. The Marlboro license expires in 1989 and we plan to renegotiate it on more favorable terms. This is a promising situation, but establishing a profitable presence will be a long-term effort.

Thailand is still closed to foreign competition. The Thai Ministry of Finance, which recognizes the revenue potential of imported cigarettes, appears to favor our entry. However, there is considerable opposition in the government. We have recently had the country included in the mandate of USCEA, and are about to file a 301 petition with the U.S. Trade Representative's Office.

Our policy has been to do business with China rather than in China. We are reviewing this approach, due to the market's strategic importance and economic changes taking place in the country. To date we have supplied only the import sector, a 20-billion-unit market which is forecast to decline due to a shortage of hard currency and the government's reduction of the duty-free allowance in October 1988. The 1.3-trillion-unit domestic market has been closed to us.

We have determined that establishing a successful manufacturing link with the Chinese is a long-term goal which is critical for realizing significant growth in the domestic market. We will concentrate our efforts on fostering good relations with the China National Tobacco Company (CNTC), the state monopoly, through technical assistance projects, and will consider investing in a joint venture if CNTC is willing to pursue one. Nevertheless we believe that substantial volume gains in this market are unlikely to occur in the near term.

The market in the U.S.S.R. is estimated at 400 billion units in 1989. Our business is limited to a small quantity of exports to duty free. We have had no access to the domestic market since our Marlboro license agreement expired in December 1985. In any agreement, the compensation requirement is 100%.

The Soviets do not give cigarettes a high priority on their economic agenda. They are more interested in developing the food industry and in joint ventures as opposed to licence agreements. We may be able to introduce a tobacco project by packaging it with commercial activities of Kraft General Foods. Presentations on the subject were made to Soviet officials in Moscow in October 1988. Discussions are continuing on several of the proposals - specifically Tang; a pilot plant for breakfast cereals; meat processing technology; and a Marlboro joint-venture agreement with India. Our plan is to link Marlboro to the completion of any deal in the U.S.S.R. However, we do not anticipate significant volume and income gains in the near term.

IV. OTHER ISSUES

Competitive Positioning

Competition is intensifying among international brands in the developed markets of the world. The large private competitors are focussing their efforts increasingly on these trademarks. PM products face competition primarily from other American-blend cigarettes: Camel, Winston, Salem, Kent, Barclay and Lucky Strike. Arrayed against these we have Marlboro, Philip Morris, Merit, Parliament, Chesterfield, Lark, Virginia Slims and L&M. Here are our plans for each.

Marlboro remains our largest selling brand, the world's number one selling cigarette and our best weapon against the competition. The brand is still young and vibrant and we plan to keep it that way through marketing and promotions aimed at young smokers. Volume will increase by 23 billion units to 190 billion in 1991. We forecast a higher rate of growth for Marlboro Lights than for Marlboro Red. This line extension will increase by eight billion units to 22 billion in 1991. Lights' growth will be fueled by sales in Germany and France, as well as in Hong Kong, China and Taiwan.

Philip Morris' share trend is up in ten of the twelve markets where it is available. We plan to increase sales by four billion units to 28 billion in 1991. We will develop existing versions of the brand, including Superlights in Europe, Japan and Australia and PM Filter Kings in France and Italy. To broaden the appeal of the franchise we will launch eight line extensions in our top markets.

Parliament has rapidly achieved popularity in Japan, Taiwan and Turkey. We plan to add another 2.5 billion units to reach ten billion in 1991 by expanding our presence in existing markets and unifying marketing with the "American Blue" campaign.

We plan to increase Merit volume by over one billion units to nine billion during the Plan period. Merit Lights has just been launched in Japan and will be a major contributor to the increase. We also plan to launch the parent brand in Hong Kong and line extensions in Italy and Switzerland.

We are optimistic about prospects for the Liggett brands, Lark, L&M and Chesterfield. We plan to grow volume by ten billion units to 38 billion in 1991. This will come from strong growth of Lark in Japan and launches of Chesterfield in Japan, Finland, Switzerland and Turkey. L&M will continue to be used as a tactical brand.

Virginia Slims has achieved a small but growing acceptance as a niche brand targeted at female consumers. We plan to broaden its base with higher DME support, specifically in Japan, Taiwan and Korea.

Overall our international brands far outsell those of the American-blend competition, and we intend to continue applying marketing pressure to widen this gap.

Sourcing

We anticipate that in the EEC our five factories will have sufficient capacity to supply our needs over the Plan period. With planned capital expenditures, capacity will be expanded to reach 45 billion units in BOZ and 42 billion in Berlin. Berlin will run two shifts and a partial third shift, to be introduced this year, will be expanded into 1991. BOZ will remain on three-shift production five days a week.

Elsewhere, capacity will be sufficient to meet our needs. Export sourcing will be mostly from the U.S. "Made in USA" is important to the quality perception of our products in many markets and is therefore desirable from a marketing point of view. Our volume forecast for U.S. exports is as follows:

	1988A	1989	1990	1991
Billions	68.8	71.3	75.6	77.8

Overall capital expenditures for PMI will total $350 million over the Plan period, which is in line with last year's Plan. This excludes expenditures for the proposed joint venture in Turkey.

Europe and 1992

The drive to create a unified market in the EEC is gaining momentum and could have far-reaching implications for our business. These include excise tax harmonization and the possibilities of cross-border sourcing within the Common Market, the standardization of warning labels, the imposition of tar ceilings and the loss of intra-EEC duty-free sales.

The critical issue is excise tax harmonization. The lack of a standardized tax structure is a barrier to a unified market for cigarettes and is the subject of much debate within the EEC. As currently proposed, harmonization would lead to an average 30% increase in the incidence of tax. There is no market where we stand to gain from its implementation and the higher taxation would lead to a decline in industry volumes. We will therefore attempt to influence the situation in such a way as to avoid any tax increase. We will also attempt to maximize the specific element in any uniform tax which is applied, since a higher specific element improves the competitive pricing of our brands vis-a-vis lower-priced products.

Corporate Affairs

Corporate affairs issues and how well we handle them will remain critical to our success. We intend to be aggressive in our determination to defend our industry and consumers and protect our marketing freedoms. Some of our plans to protect smokers' rights include opposing airline and other smoking bans, organizing scientific seminars and "healthy building" seminars to combat misinformation about ETS, counteracting the influence of WHO and developing programs for journalists to improve our ability to get our point of view across to the public and other interest groups. We are reviewing our staffing levels and will increase these as the workload relating to 1992 increases.

Summary

PMI enters the Plan period well positioned for continued volume and profit growth. 1988 was our best year ever, and one in which we continued to outperform the competition in nearly all our major markets. We plan to continue gaining share and to increase our volume at a rate of 4% per year despite declining industry volumes in some developed markets. We foresee untapped potential in others and have at our disposal an array of brands capable of realizing this. We intend to emphasize our international trademarks and keep our marketing programs young, vibrant and aggressive. Through our corporate affairs efforts we will oppose restrictions on our marketing freedoms, as well as measures aimed at punitive taxation. As a result we expect to grow earnings at a rate of 16% per year and make an increasing contribution to PM's future growth.

INCOME STATEMENT

U.S. Dollars (000) Omitted	1983 Actual	1988 Actual	1989 Original Budget	1990 Plan	1991 Plan	1992 Plan	1993 Plan	Compound Annual Growth % 1988-1993
CONSOLIDATED OPERATING REVENUES	$ 3,647	$ 8,086	$ 8,002	$ 8,790	$ 9,514	$ 10,323	$ 11,200	6.7 %
Variable Cost of Sales	896	1,684	1,708	1,914	2,086	2,324	2,583	8.9
Foreign Excise Tax	1,538	3,768	3,579	3,846	4,142	4,432	4,742	4.7
Shipping Expense	52	119	112	117	126	135	144	3.9
LIFO Adjustment	27	2	7	7	7	8	8	32.0
MARGINAL CONTRIBUTION	1,134	2,513	2,596	2,906	3,153	3,424	3,723	8.2
Fixed Manufacturing Expense	214	404	396	418	441	463	486	3.8
AVAILABLE PROFIT	920	2,109	2,200	2,488	2,712	2,961	3,237	8.9
Marketing	473	1,046	960	1,048	1,125	1,204	1,288	4.3
General and Administrative	120	207	214	222	231	241	251	3.9
Research and Development	19	48	52	54	56	59	62	5.3
Currency Translation & Hedging Cost, Net	(8)	(3)	(6)	(6)	(3)	(3)	(3)	0.0
Other Deductions/(Income), Net	(1)	85	0	41	38	38	38	(14.9)
TOTAL EXPENSES	603	1,383	1,220	1,359	1,447	1,539	1,636	3.4
Equity in Net Earnings of Unconsolidated Subsidiaries and Affiliates	58	49	49	57	64	64	64	5.5
INCOME FROM OPERATIONS BEFORE INTEREST, AMORTIZATION AND ASSESSMENTS	375	775	1,029	1,186	1,329	1,486	1,665	16.5
Interest Expense/(Income), Net	20	59	68	85	91	96	102	11.6
Amortization of Intangible Assets	5	15	6	6	6	6	6	(16.7)
Corporate Assessment, General and Administrative	0	27	29	31	33	35	37	6.5
Corporate Assessment, Interest	0	1	1	1	1	1	1	0.0
EARNINGS BEFORE INCOME TAXES	350	673	925	1,063	1,198	1,348	1,519	17.7
Provision for Income Taxes	136	287	258	295	333	376	424	8.1
NET EARNINGS	$ 214	$ 386	$ 667	$ 768	$ 865	$ 972	$ 1,095	23.2 %
NET EARNINGS EXCLUDING AFTER-TAX CORPORATE ASSESSMENTS FOR GENERAL & ADMINISTRATIVE AND INTEREST EXPENSES	$ 214	$ 430	$ 723	$ 832	$ 933	$ 1,045	$ 1,170	22.2 %

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BALANCE SHEET

U.S. Dollars (000) Omitted

ASSETS	1983 Actual	1988 Actual	1989 Original Budget	1990 Plan	1991 Plan
Cash and cash equivalents	$ 27	$ 11	$ 11	$ 11	$ 11
Accounts receivable, trade	389	287	651	694	761
Less allowances	12	16	17	19	20
	377	271	634	675	741
Notes receivable, PM Inc.	0	0	0	0	0
Notes receivable, PM Companies	0	368	0	0	0
Accounts receivable, affiliates	40	53	22	21	19
Accounts receivable, other	28	73	64	68	68
	445	765	720	764	828
Inventories:					
Leaf tobacco	409	689	665	685	714
Finished products	239	453	442	464	492
Other	65	105	106	109	113
LIFO Valuation Adjustment	0	(35)	(42)	(50)	(57)
	713	1,212	1,171	1,208	1,262
Prepaid expenses	6	37	38	38	9
CURRENT ASSETS	1,191	2,025	1,940	2,021	2,110
Investments in and loans to unconsolidated subsidiaries and affiliates	676	462	469	510	522
Long-term receivables	9	1	1	1	1
Property, plant & equipment, at cost	564	1,210	1,298	1,385	1,443
Less accumulated depreciation	172	545	604	663	725
Net Property, plant and equipment	392	665	694	722	718
Goodwill and other intangible assets, Less amortization	45	79	76	73	70
Other assets	3	64	47	28	38
TOTAL ASSETS	$ 2,316	$ 3,296	$ 3,227	$ 3,355	$ 3,459
LIABILITIES					
Notes payable	$ 116	$ 126	$ 108	$ 33	$ 31
Notes Payable, PM Inc.	0	24	0	0	0
Notes payable, PM Companies	0	0	0	0	0
Current portion of long-term debt	8	1	1	1	1
Accounts payable	62	215	112	118	124
Accounts payable, affiliates	11	273	103	105	110
Accrued excise tax liabilities	166	280	251	268	296
Accrued other liabilities	140	470	409	426	452
Income taxes payable	39	214	258	233	257
Dividends Payable	0	44	0	0	0
CURRENT LIABILITIES	542	1,647	1,242	1,184	1,271
Long-term debt	63	33	32	31	30
Debentures, PM Inc.	0	231	231	231	231
Deferred income taxes	81	120	117	122	122
Other liabilities	25	81	89	99	109
Deferred credits	2	9	9	9	9
Common Stock	0	2	2	2	2
Additional Paid-in Capital	0	1,021	1,021	1,021	1,021
Beginning Retained Earnings	1,472	1,062	(127)	206	384
Net Earnings	214	424	669	767	864
Dividends Declared	0	(1,610)	(334)	(593)	(860)
Earnings Reinvested in the Business	1,686	(124)	208	380	388
Cumulative Translation Adjustment	(232)	276	276	276	276
Total Stockholders Equity	1,454	1,175	1,507	1,679	1,687
Intracompany Account	149	0	0	0	0
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	2,316	$ 3,296	$ 3,227	$ 3,355	$ 3,459

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CASH FLOW STATEMENT

U.S. Dollars (000) Omitted

	1988 Actual	1989 Original Budget	1990 Plan	1991 Plan
CASH FLOWS FROM OPERATING ACTIVITIES:				
Net Income	$ 424	$ 669	$ 767	$ 864
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:				
Depreciation and Amortization	98	91	93	96
Deferred Taxes	(94)	(4)	5	0
Increase in Long-Term Receivables	0	(1)	0	0
Increase in Other Long-Term Liabilities	7	8	10	10
Equity in Net Earnings of Unconsolidated Subsidiaries	(49)	(49)		
Dividends from Unconsolidated Subsidiaries	49	49		
Net Increase in Working Capital	900	(280)	(65)	1
Other Net Cash Flows from Operating Activities	76	17	19	(10)
Cumulative Translation Adjustment	0	0	0	0
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,411	500	829	961
CASH FLOWS FROM INVESTING ACTIVITIES:				
Investment in and Loans to Unconsolidated Subsidiaries and Affiliates	0	(10)	(45)	(15)
Other Investing Activities	(13)	0	0	0
Capital Expenditures	(99)	(125)	(128)	(97)
Disposals of Plant, Property & Equipment, net	15	11	12	12
Other Capital Activities, Net	0	0	0	0
NET CASH USED IN INVESTING ACTIVITIES	(97)	(124)	(161)	(100)
CASH FLOWS FROM FINANCING ACTIVITIES				
Dividends Paid by PM International, Inc.	(1,566)	(334)	(593)	(860)
1989 Debenture Payment by PMIFCO	0	(24)	0	0
Decrease in Notes Payable	74	(18)	(74)	(2)
Decrease in Current Portion of Long-Term Debt	(11)	0	0	0
Decrease in Long-Term Debt (excludes Notes Payable)	(45)	(1)	(1)	(1)
Increase in Other Long-Term Liabilities	4			
Decrease in Notes Receivable From Consolidated Affiliates	256			
NET CASH PROVIDED BY FINANCING ACTIVITY	(1,288)	(377)	(668)	(863)
Effect of Exchange Rate Changes on Cash	(36)	0	0	0
Net Increase in Cash and Cash Equivalents	(9)	0	0	0
Cash and Cash Equivalents at Beginning of Year	20	11	11	11
Cash and Cash Equivalents at End of Year	$ 11	$ 11	$ 11	$ 11

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Kraft General Foods Group

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of Kraft General Foods Group's forecasted industry environment.

KRAFT GENERAL FOODS GROUP

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Kraft Strategic Plan and General Foods Strategic Plan Summary

I. BACKGROUND

General Foods' Strategic Plan plus Kraft's Strategic Plan add to positive combined results. The combined plans will deliver significant improvement in income from operations, margin and return on management investment (ROMI):

	1986	1987	1988	1993	CAGR '86-'88	CAGR '88-'89	CAGR '88-'93
Oper. Rev. ($Billions)	18.1	20.7	22.5	31.2	11.7%	6.4%	6.7%
Income from Oper. ($MM)	1.484	1.652	1,685	3,352	6.6%	28.9%	4.7%
I.F.O. Margin (%)	8.2	8.0	7.5	10.7	(.7) pt.	1.6pt	3.2pt
ROMI	30.5	30.2	24%	28%	(.1) pt.	0.9pt	6.5pt

The Plan summaries that follow have been re-written to reflect the new organization alignment. However, the development of the plans was done by the old Kraft and GF Operating Units. Therefore, this document should be viewed as bridge between the separate Kraft and General Foods plans developed last year and a combined Kraft General Foods plan to be developed this year.

Kraft General Foods has been organized into seven operating divisions with combined 1989 revenue of $24 Billion and income from operations of $2.2 Billion. As now structured, Kraft General Foods is the second largest food company in the world after Nestle, with resources greater than most direct competitors. As such, Kraft General Foods has important strengths to exploit but also issues to address.

In terms of major strengths, KGF in the U.S. is the largest company in Retail Grocery Refrigerated and Frozen and number two in Foodservice, with significant sales/distribution capabilities in all categories:

U.S.	1988 KGF Operating Revenue ($B)
Grocery	6.2
Refrigerated	4.9
Frozen	1.7
Foodservice	3.1

KGF occupies strong leadership share positions in most of its major categories, including Cheese, Dressings, Powdered Beverages, Dry Desserts, Frozen Toppings, Ice Cream, Frozen Bagels, and Pasta Dinners. Further, KGF has an established international infrastructure and solid positions in economically developed markets.

In addition, KGF has proprietary and/or leading technical positions in multiple important food and packaging areas, including Fat Replacement technologies and know-how, the most significant new food technology arena.

While KGF has, on balance, more strengths than weaknesses, there are several areas of concern that future efforts must address with priority. Chief among these is that Kraft and General Foods combined growth and returns over the past few years have been only average in comparison to the Food Peers Group.

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Specifically, compared to fifteen food and beverage companies, KGF would have ranked in the middle in growth of operating revenue and income from operations, in operating margin and in return on identifiable assets:

KGF:	1988 %	1988 RANK	1987 %	1987 RANK	1986 %	1986 RANK
Growth in Op. Revenue	9.1	9	14.3	7	6.2	10
Growth in I.F.O.	6.6	12	10.9	11	9.1	10
Growth in I.F.O. Margin	8.3	12	8.5	12	8.8	11
R.O.I.A.	18.3	9	18.6	7	18.0	6
Base - 15 peer companies						

While 57% of the Revenue and 79% of Income from Operations are generated by businesses we feel are strategically sound, there are several weak or troubled businesses impacting financial performance. Among these are latter are Cereal (weak, declining share); Coffee (unacceptable financials); Pourable Salad Dressings (declining share); RTD Beverages (unacceptable financials); and Latin America (high inflation, marginal scale).

Other major concerns center on important external threats. We view our largest single threat as vulnerability to fat/cholesterol concerns and competitors' potentially superior solutions. In addition, KGF faces very strong competition in several important categories, especially Coffee, Cereal, Mayonnaise and Pourable Salad Dressing.

Our assessment of the situation is that the balance is still toward KGF strengths and that we can overcome or resolve our concerns and issues. Therefore, the overall strategic thrust will be aggressive, beginning with the establishment of this "Working Mission":

Kraft General Foods' Mission is to become the leading food company in the world, based upon achieving superiority versus competition on a balance of these factors:

- Outstanding overall quality in all aspects of operations
- Return on management Investment and on Equity
- Rate of real growth in Unit Sales and Operating Income
- Productivity
- Innovation

To achieve this Mission and to facilitate strategic planning across our seven business units, we are: a) doing extensive portfolio analysis to assess individual businesses, b) assessing their strategic needs, and c) assuring linkage of business unit strategies and action plans to situational assessments and KGF's overall strategies.

Based upon preliminary work completed, we have grouped the KGF business unit portfolio into three strategic segments in order to provide an understanding of which businesses need greater, focused attention. Our criteria for these groupings follow:

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KGF Strategic Portfolio Classification - Criteria

SOUND
- ACCEPTABLE FINANCIALS
- STABLE/GROWING SHARES
- HEALTHY CATEGORY/COUNTRY
- CLEAR-CUT STRATEGIC POSITION

TRANSITIONAL
- MARGINAL FINANCIALS
- WEAK/DECLINING SHARE
- WEAK CATEGORY/COUNTRY
- SOFT STRATEGIC POSITION
- NO FUNDAMENTAL STRATEGIC WEAKNESSES
- NEW PRODUCTS

PROBLEM
- UNACCEPTABLE FINANCIALS
- WEAK/DECLINING SHARE
- PROBLEM CATEGORY/COUNTRY
- STRATEGIC WEAKNESS

Based upon 1988 results, 57% of 1988 KGF operating revenues and 79% of I.F.O. is in Sound businesses:

	SOUND	TRANSITIONAL	PROBLEM
GF - USA	STUFFING PACKAGED DESSERTS BEVERAGE MIXES (DRY) BAKERY R.T.E. DESSERTS	ENHANCERS RICE SHELF STABLE MEALS	COFFEE CEREAL RTD BEVERAGES PASTA
KRAFT - USA	CHEESE VISCOUS DINNERS BBQ SAUCE	MARGARINE	POURABLE DRESSINGS
OSCAR MAYER	PROCESSED MEAT PICKLES ENTREES	SURIMI LUNCHABLES (DEV) ZAPPETITES (DEV)	
FROZEN	VEGETABLES PIZZA BAGELS TOPPINGS CULTURED	ICE CREAM	NOVELTIES
CANADA	KRAFT CANADA	HOSTESS	RTD BEVERAGES COFFEE
INTERNATIONAL	EUROPE	ASIA/PACIFIC	LATIN AMERICA
COMMERCIAL		OIL FOOD SERVICE SPECIALTY INGREDIENTS	
'88 Oper. Revenue	57 %	29 %	14 %
'88 Inc. From Oper.	79 %	14 %	7 %

II. OVERALL KGF OBJECTIVES AND STRATEGIES

KGF will support its leadership Mission with financial objectives aimed at putting KGF in the top quartile of Food Industry performance:

PERFORMANCE MEASURE	TOP QUARTILE PEER GROUP	KGF (WKG) OBJECTIVES	KGF PROJECTIONS
OPERATING REVENUE GROWTH	11%	10%	7%
INCOME FROM OPERATIONS GROWTH	14%	15%	13%
INCOME FROM OPERATIONS MARGIN	17%	10-11%	11%
RETURN ON IDENTIFIABLE ASSETS	22-23%	25%	21%

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Toward these objectives, KGF will follow six overall strategies:

KGF Overall Strategies Summary

1. Focus resources on countries, categories, and brand franchises with significant profit and return potential, and where KGF has or can develop a sustainable competitive advantage, and thus a leadership position.

   Avoid or exit/harvest other businesses.

2. Categorize and manage new business development activities to avoid undue risk. Focus on profitability rather than volume potential

   Defend established businesses ferociously. (Remember that best defense is strong offense.)

3. Identify and leverage all possible synergies among KGF units (and other P.M. companies, as appropriate) that will strengthen our marketing effectiveness with end user consumers and the trade.

4. Pursue optimum asset and expense productivity in all business units on a continuing basis, using formalized and documented:
   - Quantified goal setting
   - Project identification
   - Implementation plans (w/specified accountability, responsibility, authority, timing)
   - Performance tracking

5. Manage all aspects of KGF's business with a global perspective; seek and leverage business system opportunities on an optimum source basis.

6. Be organizationally flexible, to allow adjustments necessary to leverage synergies and maximize productivity

Each Operating Unit's initiatives would link to overall Corporate strategies with certain key planning implications.

KGF's Six Corporate Strategies -- Planning Implications

Strategies	Planning Implications For Operating Units
Focus Resources	• Seek sustainable competitive advantages • Concentrate on growth categories • Be prepared to harvest/exit unfixable businesses
Protect, Grow the Business	• Recognize differing risk profile in business development, e.g. close-in vs unrelated business • Emphasize innovation to preempt competition • Accommodate need for ferocious defense spending • Prefer profit/return over volume
Leverage Synergies	• Identify/exploit synergies in all functional areas • Involve other P.M. companies wherever appropriate
Pursue Productivity	• Share Kraft and GF productivity in all areas • Organize/staff to provide sharp, continuing focus on specific productivity plans and progress
Manage Globally	• Take worldwide view; technology, procurement, operations marketing, people • Capitalize on changes in International Trade regulations • Exploit expansion opportunities • Coordinate with other P.M. companies as appropriate
Be Organizationally Flexible	• Be prepared to adjust organization according to opportunity • Deploy staff based upon need • Assume productivity not growth will drive long-term headcount

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III. **FINANCIAL RESULTS**

General Food's strategic plan plus Kraft's strategic plan add to positive combined results.

($MM) Combined General Foods/Kraft Strategic Plans

	1988	1989	1990	1991	1992	1993	'88-'93 C.A.G.R.
OPERATING REVENUES (GROUPS)	22,540	23,972	25,337	27,446	29,424	31,617	7.0%
MANAGEMENT JUDGEMENT	--	--	--	(66)	(196)	(383)	
OPERATING REVENUES (ADJUSTED)	22,540	23,972	25,337	27,380	29,228	31,234	6.7%
% CHANGE VS PRIOR YR.	--	6.4%	5.7%	8.1%	6.7%	6.9%	

	1988	1989	1990	1991	1992	1993	'88-'93 C.A.G.R.
INCOME FROM OPERATIONS (GROUPS)	1,685	2,171	2,397	2,754	3,130	3,507	15.8%
MANAGEMENT JUDGEMENT	--	--	--	(40)	(104)	(155)	
INCOME FROM OPERATIONS (ADJUSTED)	1,685	2,171	2,397	2,714	3,026	3,352	14.7%
% CHANGE VS PRIOR YR.	--	28.8%	10.4%	13.2%	11.5%	10.8%	

Each Operating Unit plans to deliver growth and earnings

	OPERATING REVENUE			INCOME FROM OPERATIONS		
	1988	1993	CAGR(%)	1988	1993	CAGR(%)
G.F. USA	4,955	6,419	5.3	324	744	18.1
KRAFT USA	4,114	5,720	6.8	558	1,167	15.9
FROZEN PROD.	2,031	3,169	9.3	134	345	20.9
CANADA	1,411	1,664	3.4	167	234	7.0
INTERNATIONAL	4,046	5,901	7.8	336	573	11.3
OSCAR MAYER	2,200	3,320	8.6	195	304	9.3
COMMERCIAL	3,592	5,420	8.6	103	291	23.1
TOTAL GROUPS	22,349	31,613	7.2	1,817	3,658	15.0
HQ, R&D, & ALL OTHER	191	4		(131)	(151)	
MGMT. JUDGEMENT	--	(383)		--	(155)	
TOTAL KRAFT GEN. FOODS	22,540	31,234	6.7	1,686	3,352	$\boxed{14.7}$

Four groups (International, Commercial, Kraft USA and GF USA) will contribute 74% of the revenue growth over the period.

Source of O.R. Growth

INT'L	COMMERCIAL	KRAFT USA	GF USA	FROZEN	OSCAR MAYER	CANADA
20%	20%	18%	16%	12%	11%	3%

Productivity will be a key driver behind our improved earnings performance

	1988	1989	1990	1991	1992	1993	'88-'93 CHNG
ACCT. REC. DAYS	25	28	28	27	27	27	2 days
INVENTORY DAYS	64	62	61	59	58	57	(7) days
FIXED ASSET TURNS	4.7	4.6	4.5	4.6	4.6	4.6	(0.1) turns
O.R./EMPLOYEE ($M)	233	248	262	283	302	323	$90 M
I.F.O./EMPLOYEE ($M)	17	22	25	28	31	35	$18 M

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The combined plans result in a steady and substantial improvement in cash flow totalling $6.7 billion over the plan horizon

KRAFT GENERAL FOODS
STRATEGIC PLAN
CASH FLOW 1989-1993

$MM	1989	1990	1991	1992	1993	TOTAL 89-93
NET INCOME	406	550	762	952	1,188	3,858
ADD: NET CORP. ASSESSMENTS	708	690	659	651	602	3,310
NET INCOME BEFORE CORP ASSESS.	1,114	1,240	1,421	1,603	1,790	7,168
DEPRECIATION/AMORTIZATION	787	799	837	865	890	4,178
DEFERRED TAXES	345	250	140	90	83	908
CHANGE IN WORKING CAPITAL	(469)	(226)	(176)	(270)	(95)	(1,236)
FUNDS FROM OPERATIONS	1,777	2,063	2,222	2,288	2,668	11,018
CAPITAL EXPENDITURES	(833)	(869)	(842)	(838)	(918)	(4,300)
OTH. INVEST/ACQ. NET OF DIVEST.	10	(1)	22	10	8	49
FREE CASH FLOW	954	1,193	1,402	1,460	1,758	6,767

Capital expenditures will be increased and directed to productivity and expansion projects to achieve volume and income targets.

Capital Expenditures ($MM)	'86-'87	'88-'93
Total	1,215	5,044
Avg. Per Year	608	841

V. SUMMARY

The plans prepared separately by General Foods and Kraft project positive results. As we add a KGF perspective to these plans, we can expect to see the views of some businesses move up or down. Overall, we expect that the integrated KGF long range plan will project better results than the present add-up based upon positive contributions from synergies and productivity. The creation of an integrated plan has begun, but will take most of 1989 to complete.

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KRAFT GENERAL FOODS
FINANCIAL STATEMENTS

	1986	1987	1988	1989	1990	1991	1992	1993	CAGR 86-88	CAGR 88-89	CAGR 89-93
Operating revenues	18081.2	20663.9	22539.7	23971.5	25337.4	27379.7	29227.9	31234.2	11.7%	6.4%	6.8%
Cost of product & shipping exp	10830.9	12457.4	13622.7	14226.2	14806.7	15945	16996.2	18136.7	12.2%	4.4%	6.3%
LIFO adjustment	57.4	-96.4	25.8	1.3	0.9	7.8	9.9	10.1			
Total cost of sales	10888.3	12361.0	13648.5	14227.5	14807.6	15952.8	17006.1	18146.8	12.0%	4.2%	6.3%
Marginal Contribution	7192.9	8302.9	8891.2	9744.0	10529.8	11426.9	12221.8	13087.4	11.2%	9.6%	7.7%
Fixed manufacturing costs	1093.7	1189.9	1254.8	1387.1	1475.3	1562.4	1639.5	1722.3	7.1%	10.5%	5.6%
Available profit	6099.2	7113.0	7636.4	8356.9	9054.5	9864.5	10582.3	11365.1	11.9%	9.4%	8.0%
Marketing	3971.0	4671.7	5003.4	5239.7	5694.7	6135.7	6493.1	6891.1	12.2%	4.7%	7.1%
General and Admin.	527.8	663.7	841.0	751.0	785.1	825.6	863.8	909.2	26.2%	-10.7%	4.9%
R & D	171.4	185.5	193.0	198.4	181.8	191.6	207.4	218.8	6.1%	2.8%	2.5%
Curr. Trans./hedging costs	-3.1	-9.3	3.7	5.7	5.0	5.0	5.0	5.0	-	-	-3.2%
Other (inc)/exp	-18.3	-31.4	-74.3	10.1	11.2	13.8	10.9	14.9	-	-	10.2%
Restructuring charge	0.0	0.0	348.0	0.0	0.0	0.0	0.0	0.0	-	-	-
Total expenses	4648.8	5480.2	6314.8	6204.9	6677.8	7171.7	7580.2	8039.0	16.5%	-1.7%	6.7%
Earnings in uncons subs	33.6	19.1	16.3	19.4	20.6	21.6	23.6	25.6	-30.3%	19.0%	7.2%
Income from Ops. before Interest, Goodwill & Assessments	1484.0	1651.9	1337.9	2171.4	2397.3	2714.4	3025.7	3351.7	-5.1%	62.3%	11.5%
% operating revenues	8.2%	8.0%	5.9%	9.1%	9.5%	9.9%	10.4%	10.7%			
Merger-related expenses	0.0	0.0	281.6	0.0	0.0	0.0	0.0	0.0	-	-	-
Net interest exp/(inc)	126.1	173.8	294.5	210.1	201.0	185.0	183.6	176.6	52.8%	-28.7%	-4.2%
Goodwill amortization	118.3	141.7	156.7	376.5	376.7	376.7	376.7	376.7	15.1%	140.3%	0.0%
Corporate Assessments - G & A	6.8	23.8	26.8	55.8	58.7	61.9	65.3	68.7	98.5%	108.2%	5.3%
- Interest	20.8	35.4	26.9	551.0	537.1	514.8	505.5	455.1	13.7%	1948.3%	-4.7%
Earnings before taxes & spec. charge	1212.0	1277.2	551.4	978.0	1223.8	1576.0	1894.6	2274.6	-32.5%	77.4%	23.5%
Income taxes (1)	590.2	606.2	345.6	571.6	674.1	814.2	942.2	1087.0	-23.5%	65.4%	17.4%
Net earnings before special charges	621.8	671.0	205.8	406.4	549.7	761.8	952.4	1187.6	-42.5%	97.5%	30.7%
Special charges, net of taxes (2)	0.0	1.2	-32.3	0.0	0.0	0.0	0.0	0.0	-	-	-
Net earnings	621.8	672.2	173.5	406.4	549.7	761.8	952.4	1187.6	-47.2%	134.2%	30.7%

(1) 1988 total taxes including the tax effect of special charges equaled $345.7mm.

(2) 1987 special charge is the total of Kraft's cumulative effect of accounting change of $45.2mm and GF's reorganization expense of $71.0mm net of taxes based on an effective rate of 38%. 1988 special charge is GF's cumulative effect of accounting change of $32.3mm.

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KRAFT GENERAL FOODS
GROUP: TOTAL
MANAGEMENT INVESTMENT

($ MM)

	1988	1989P	1990	1991	1992	1993
NET RECEIVABLES	1,561	1,827	1,921	2,057	2,190	2,332
NET INVENTORIES	2,472	2,533	2,613	2,713	2,833	2,939
PREPAID EXPENSES	183	111	109	107	105	105
NOTES PAYABLES	231	234	327	363	372	395
A/P & ACCRUED LIABILITIES	3,619	2,976	2,923	2,999	3,083	3,180
WORKING CAPITAL	366	1,261	1,393	1,513	1,672	1,800
NET PROP, PLANT & EQUIP	4,810	5,231	5,674	6,041	6,381	6,776
INV & ADV TO UNCONS SUBS	376	396	421	431	461	497
TOTAL Y/E MANAGEMENT INVESTMENT	5,552	6,888	7,488	7,986	8,514	9,073

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KGF
CASH FLOW STATEMENT

($millions)

Source/(Use) of Funds	1988	1989	1990	1991	1992	1993
Net Income	174	406	550	762	952	1,188
Add: Net Corporate Assessments	158	708	690	659	651	602
Net Income Before Corporate Assessments	332	1,114	1,240	1,421	1,603	1,790
Amortization	157	376	376	376	376	376
Depreciation	329	411	423	461	489	514
Deferred Taxes	57	345	250	140	90	83
Change in Accounts Receivable	15	(266)	(93)	(137)	(132)	(142)
Change in Inventory	(3)	(61)	(80)	(99)	(120)	(106)
Change in A/P & Accrued Liabilities	355	162	88	204	219	214
Change in Income Taxes Payable	0	(23)	19	(22)	17	13
Other, net	(82)	(281)	(160)	(122)	(254)	(74)
Funds from Operations	1,160	1,777	2,063	2,222	2,288	2,668
Capital Expenditures	(729)	(833)	(869)	(842)	(838)	(918)
Other Invest & Acquis, net of Divest	389	10	(1)	22	10	8
Free Cash Flow	820	954	1,193	1,402	1,460	1,758
Long Term Debt Retired	(196)	(140)	11	(63)	(294)	4
Net Interest Expense(After Tax)	(141)	(674)	(654)	(620)	(610)	(560)
Corporate Assessment(After Tax)	64	(34)	(36)	(39)	(41)	(42)
Reduction of Untendered Kraft Stock	(704)	(330)	0	0	0	0
Financing Provided	(977)	(1,178)	(679)	(722)	(945)	(598)
Change in Intercompany Account	(158)	(224)	514	680	515	1,160

General Foods, USA

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of General Foods, USA's forecasted food industry environment.

GENERAL FOODS, USA

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GENERAL FOODS USA FIVE-YEAR PLAN

OBJECTIVES

Overall

1. Grow volume and operating income faster than the domestic food segment of major packaged food companies while investing for the future.

2. Earn a competitive return on assets.

	1988-93 Plan ex Maxwell House and Foodservice	1988-93 Plan incl Maxwell House and Foodservice
Volume	2%	2%
Operating Income	11%	18%
Operating Return on Assets	16-20%	8-16%

Business Units

1. Grow volume and operating income faster than direct competitors. Improve share.

2. Product quality will be measurably superior to direct competitors.

3. Earn a competitive return.

General Foods USA is composed of the following major businesses: Baked Goods, Cereals, Desserts, Beverages, Meals, Shelf Stable Foods, Coffee, and Foodservice. Its dimensions are:

	1989 Original Budget
Net Revenue	$5.1 Billion
Income from Operations	$425 Million

General Foods USA's objectives have not changed over the last several years. Our overall objectives are to grow volume and income from operations faster than the domestic food segment of major packaged food companies while generating competitive returns.

We require that our business units out-perform their direct competitors in growth of volume (market share) and income from operations, while earning comparable returns. Product quality is a fundamental driver of market share and volume and is receiving high emphasis throughout the organization.

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GENERAL FOODS USA FIVE-YEAR PLAN

PERFORMANCE VS. COMPETITION*

DOMESTIC GROCERY UNIT VOLUME TRENDS 1984-87

CURRENT PORTFOLIO VOLUME MOMENTUM (Excluding Acquisitions)		TOTAL VOLUME GROWTH ABSOLUTE (Including Acquisitions)	
KELLOGG	6%	RALSTON PURINA	14.4%
GENERAL FOODS USA	2.5%	QUAKER OATS	12.2%
H.J. HEINZ	1.6%	KELLOGG	6.0%
RALSTON PURINA	1.6%	PILLSBURY	4.8%
GENERAL MILLS	0%	GENERAL FOODS USA	2.5%
PILLSBURY	-0.1%	H.J. HEINZ	2.5%
RJR NABISCO	-0.6%	GENERAL MILLS	1.6%
QUAKER OATS	-0.8%	CAMPBELL SOUP	-1.4%
CAMPBELL SOUP	-1.5%	RJR NABISCO	-2.2%
MEDIAN	0		3.7%
SAMI DRY & FROZEN	0.7		NOT APPLICABLE
NIELSEN SELECTED 49	1.0		NOT APPLICABLE

Volume Growth

Recent three year volume trends show that General Foods USA volume performance compares favorably to the domestic grocery volume growth of competitors. The volume growth of the General Foods USA portfolio excluding any impacts from acquisition or divestiture activities (momentum) exceeded the competitive median by a significant margin. The expansion of GF USA's total volume base after fully recognizing the impacts of M&A activities (absolute) was below the median performance of the competitor group. During the 1984-87 period several competitors expanded their volume base by making significant acquisitions. General Foods USA's only significant acquisition during this period was Freihofer which occurred late in 1987.

SAMI and Nielsen data for 1988 is not yet fully available, however, General Foods USA is expected to have out performed competitors on both a momentum and absolute basis. The impact of the Freihofer acquisition raised absolute volume growth performance in 1988 to over 7%, while portfolio momentum was in excess of 3%.

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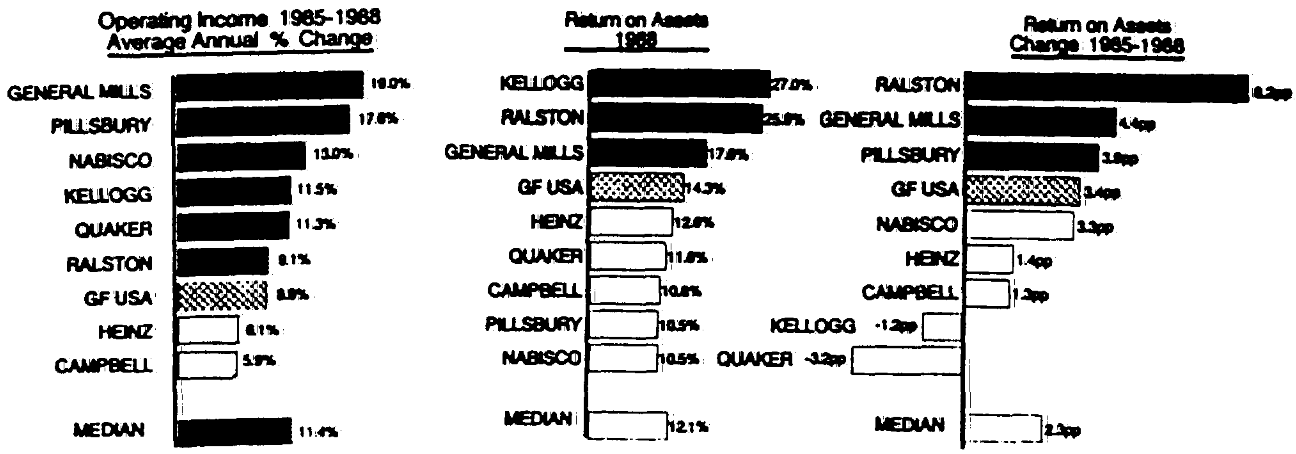
* Performance comparisons for General Foods and competitors are based on domestic grocery businesses excluding Coffee and Foodservice.

GENERAL FOODS USA FIVE-YEAR PLAN

PERFORMANCE VS. COMPETITION*



Operating Earnings Growth

Operating income for General Foods USA did not keep pace with the domestic grocery performance of competitors over the three year period 1985-88. The slower growth posted by General Foods USA during this period reflects a period of restrained pricing, and significant investment in several large development programs. Comparisons of competitors are also influenced unfavorably by the execution of large acquisitions by several competitors, namely Quaker and Pillsbury.

Although the three year growth rate for operating earnings is below the competitive median, during the last two years of the period, 1987 and 1988, GF USA grew operating income faster than the median rate for competitors (12.2% vs. 8.4%).

Return on Assets

GF USA generated an operating return on assets of 14.2% in 1988, significantly above the 12.1% median return generated by competitors. GF improved returns by 3.2pp, while the median change for competitors was only 2.3pp.

* Performance comparisons for General Foods and competitors are based on domestic grocery businesses excluding Coffee and Foodservice.

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GENERAL FOODS USA FIVE-YEAR PLAN

KEY EVENTS - 1988

- Maxwell House Coffee Co. results disappointing
- Results satisfactory excluding coffee

Volume	+ 3.4%
Earnings	+14.3%

- Strategic changes are . . .
  - Coffee strategies and specific programs identified to restore franchise health and profitability
  - Continuation of shift to nearer-in development
  - Seeking greater differentiation for Post Cereals

1988 results for Maxwell House Coffee Co. were disappointing with volume declining 15% and earnings down $51 million versus 1987. However, share momentum was reestablished in the latter part of the year with December Quarter share 35.9% versus 32.1% in the March Quarter of 1988. Major progress was made in improving the quality of coffee products relative to competition.

General Foods USA grocery business excluding Coffee and Foodservice grew volume in 1988 at 3.4%. This exceeded recent history, Original Budget, and competitive performance. Earnings growth at +14.3% was on Plan and significantly ahead of competition.

Share grew in many key franchises -- powdered soft drinks, Jell-O packaged desserts, Cool Whip, Stove Top and a number of markets performed better than historical trend -- powdered soft drinks, gelatin and toppings. Cereal share declined, RTD beverages share advanced but is below expectation, and Minute Rice was impacted by the launch of Uncle Ben's Instant Rice.

Development performance was better than recent years, but there is still room for improvement. The Ready-to-Eat Desserts program is proceeding successfully and Jell-O Pudding Snacks are now available in 74% of the U.S. Freihofer Baking Co. was successfully integrated on Plan and Entenmann's was expanded to Northern California. But, there was slow progress in reaching yield/cost targets on Impromptu shelf-stable meals and lack of success in acquiring a production base. Culinova (refrigerated meals) did not succeed in establishing a viable business and Thomas Garraway (direct marketing of specialty foods) failed in expansion.

The strategies established in 1987 for the most part remain valid. Only a few changes are being made in this year's plan. The shift in development strategy begun last year is being accelerated, shifting efforts away from longer term more uncertain projects and increasing focus on projects more closely related to current business systems. The Post Cereal strategy has been redefined to establish a high taste position to differentiate the Post line from those of Kellogg and General Mills. Marketing programs are being targeted more closely at prime Post prospects and sales support at retail is being strengthened. Coffee strategies are focused on rebuilding share through product quality and new products, improving the margin mix with higher margin products, and reducing costs.

General Foods USA Five-Year Plan

Key Decisions

- Capital approved for new third cereal plant.
- Dry dessert plant restructuring approved.
- Change in trade deal policy.
- General Managers given accountability for all distribution channels.
- Decisions not to invest further in Culinova and Garraway.

There were a number of key decisions made during 1988 which will improve future performance of General Foods USA. Capital was approved to expand ready-to-eat cereal capacity and provide new process capabilities. The new third cereal plant is under construction in Jonesboro, Arkansas. Timing of the opening of this plant is being reassessed in light of current lower share and volume performance. The closing of a dry dessert plant in Lafayette, Indiana was also approved in order to eliminate costs associated with capacity no longer needed at this location. A new trade deal policy was announced to enable better control of expenses and facilitate better integration of GF USA marketing objectives with specific customer needs. General Managers were given accountability for development of their businesses in all channels including non-traditional channels such as convenience stores and club stores. Decisions were also made to curtail further investment in several new business efforts: Culinova (refrigerated meals) and Thomas Garraway (direct marketing of specialty foods). In the case of Culinova, the learnings and some capabilities are being transferred to Kraft's Chillery Fresh Foods project.

General Foods USA Five-Year Plan

Strategies - Product Portfolio

Established Businesses

1. Grow volume and earnings to their realistic potential using internal development to leverage existing assets and trademarks. These projections include established businesses and related development.

2. Where volume growth potential is limited, manage costs to achieve earnings growth.

3. Manage for cash or divest declining businesses with limited strategic value, e.g., Baking and Canning businesses are being managed for cash.

Development

4. Manage total investment based on affordability.

5. Successfully commercialize Key Growth Opportunities using acquisitions when new business capabilities or assets are needed.

Current List	Deletions
Ready-to-Eat Desserts	Culinova, refrigerated meals
Shelf-Stable Meals	Thomas Garraway, specialty foods
Liquid Beverages	

6. Add one or two new businesses for their growth potential through the 1990's.

The importance of GF USA's established businesses dictate that they be managed to generate real earnings growth. Several large businesses such as Cereals and Enhanced Starches and Side Dishes, present opportunities to compete for increased share in growing profitable categories. Other significant GF USA businesses like Packaged Desserts and Powdered Soft Drinks have achieved strong share leadership positions in mature categories where costs must be managed aggressively to generate real earnings growth and selected new product programs must be pursued to stabilize category volume trends. The Coffee business has lost share in a declining category and requires aggressive cost management and improved pricing realization to improve margins. In addition, new coffee products will be introduced to help offset market-related volume declines and improve product mix.

The three internal development programs classified as Key Growth Opportunities will contemporize our product portfolio by adding products which are high quality, ready-to-eat or easy to prepare, and portable. Investments in fixed assets required to fully commercialize these programs will be made consistent with confirmation in the marketplace of each program's potential.

Sustaining growth momentum through the 1990's will require GF USA to add one or two new businesses to the portfolio beyond the Key Growth Opportunities currently being pursued. Acquisition has historically proven to be the most successful way for GF USA to add new businesses. The first several years of the plan will be used to identify attractive categories and potential companies for acquisition, with actual execution not anticipated until the 1991-1993 period.

GENERAL FOODS USA FIVE-YEAR PLAN

STRATEGIES - BUSINESS SYSTEMS

1. Make products broadly accessible to customers and consumers by assuring strong sales and distribution capabilities covering attractive forms and channels. Increase capabilities to access convenience stores and food service channels.

2. Structure a flexible manufacturing capability to provide high quality products at competitive costs while maintaining a commitment to employees.

3. Focus information capabilities on a few key areas: Computer Integrated Logistics, Computer Integrated Production, Local Marketing, Data Base Marketing, and significant cost reduction activities.

4. Focus Technical Research on areas which support and technically lead achievement of volume and earnings growth goals. Current areas of focus are:
   - Nutrition and Well Being
   - Preservation
   - Biotechnology

5. Enhance marketing capabilities to build the consumer equity of GF USA franchises. Increase the effectiveness and use of direct and local marketing, and strengthen direct communication links to consumers.

General Foods USA will use key business systems to be a source of competitive advantage in effectively and efficiently meeting consumer and customer needs.

Maintaining and increasing current sales and distribution capabilities are priorities. Expanding our access to new channels will complement our Key Growth Opportunities which are developing products with high convenience and portability.

General Foods USA is restructuring its manufacturing capabilities to improve costs through the decision to close the Lafayette Dry Desserts Plant; and to add cereal capacity through the addition of the Jonesboro Plant, and the addition of equipment to the Mason City, Iowa ready-to-eat desserts plant.

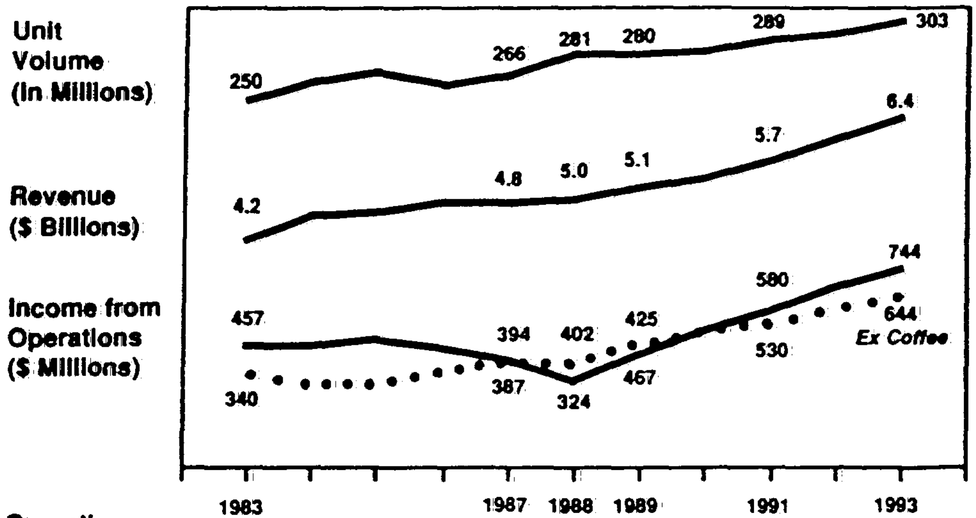
The capability to gather and effectively link information about consumers, sales, manufacturing, and inventories will increasingly be a critical leverage point of our businesses. We are concentrating our information resources on areas which will ensure our competitiveness and produce near-in benefits.

Our three technology thrusts will help us to better meet consumer desires for products which are lower in fat and cholesterol, highly convenient to use, high quality, safe, and represent good value for the price charged.

In the area of marketing, we are committed to building the equity of our franchises through advertising, promotion, and packaging in order to enhance our ability to compete on the basis of added value rather than price; to developing and structuring programs for specific customers and local markets; and to strengthen our direct communication via the "800" number and with marketing programs which communicate more directly with targeted consumer groups.

General Foods USA Five-Year Plan

Financial Overview



Average Annual Growth	1983-1988	1988-1993
Unit Volume	2.3%	1.5%
Revenue	3.2%	5.3%
Income from Operations	(6.6)%	18.0 %
	3.5% *	9.8% *

	1983	1987	1988	1989	1991	1993
Operating Margin (%)	10.8	8.1	6.5	8.3	10.2	11.6

* Ex Coffee results

General Foods USA volume and revenue have shown modest growth over the last five years. This progress has been driven primarily by the acquisition of Oroweat, Ronzoni and Freihofer as well as the commercialization of ready-to-eat desserts and ready-to-drink beverages. Growth generated from acquisitions and development activity has offset the impact of declining growth trends across several established franchises, most notably coffee, dry desserts and the enhancers.

General Foods USA earnings declined on average 6.6% over the past five years, heavily impacted share losses and competitive spending in coffee and heavy investment behind key development programs. Excluding coffee, income growth has been modest, +3.5%, with growth in the established businesses, overhead savings from the 1987 restructuring and favorable pension expense offsetting the impact of heavy development program activity.

The 1989-1993 plan delivers growth across all key financial measures. Volume growth will be generated by maintaining established franchises in declining markets and internally developing and commercializing several new product categories. Operating revenue growth is driven by volume growth and pricing to cover anticipated cost increases before the impact of productivity programs. Income growth will average 18.0% annually, well ahead of historical performance and driven by a major turnaround of the coffee business, real earnings growth on other established businesses, commercializing and expanding key development projects and new overhead restructuring programs. Operating margins will expand to 11.6% in 1993 reflecting the movement of coffee from a loss to a profit position, variable margin expansion due to the impact of productivity programs, cost savings from new restructuring programs, and development program success.

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GENERAL FOODS USA FIVE-YEAR PLAN

FINANCIAL OVERVIEW

(In Millions)

Source of Volume and Earnings Growth 1988-1993

	Volume		Earnings	
	Units	CAGR	$	CAGR
Major Businesses				
Coffee	4		$178	
Cereals	6		78	
Bakery	4		48	
Powdered Soft Drinks	(6)		35	
Packaged Desserts	(2)		24	
Food Service	1		20	
Key Development Programs				
Shelf-Stable Meals	24		38	
Ready-To-Eat Desserts	9		62	
Ronzoni	1		10	
Ready-To-Drink Beverages	-		17	
All Other	5		4	
Provision	(24)		(94)	
GF USA	22	1.5%	$420	18.0%

Future volume growth of 1.5% (22 million units) will be achieved though volume stability on the established businesses and commercialization of key development programs. Established volume gains from cereals, bakery and coffee will be offset by market driven declines in powdered soft drinks and packaged desserts. Commercialization of shelf-stable meals and expansion of ready-to-eat desserts will contribute 33 million units of growth by 1993.

Income from Operations is projected to grow $420 million or 18.0% annually (12.3% real) with most established businesses generating real earnings growth and key development programs moving into a profit generating position by 1993. The coffee business projects a major turnaround in income through the improvement of their share position and an improved margin structure as benefits of product portfolio mix improvements, improved price realization, and agressive cost reduction efforts are realized. Cereal income growth reflects continued market growth, improving share position, continued industry pricing and productivity-driven , margin expansion. Bakery income growth is primarily due to volume momentum and aggressive cost elimination programs. Powdered soft drink income growth is driven by tight cost management to offset market-driven volume declines.

Planning provisions for both volume and earnings have been added to hedge the risk surrounding the development portfolio and coffee earnings recovery.

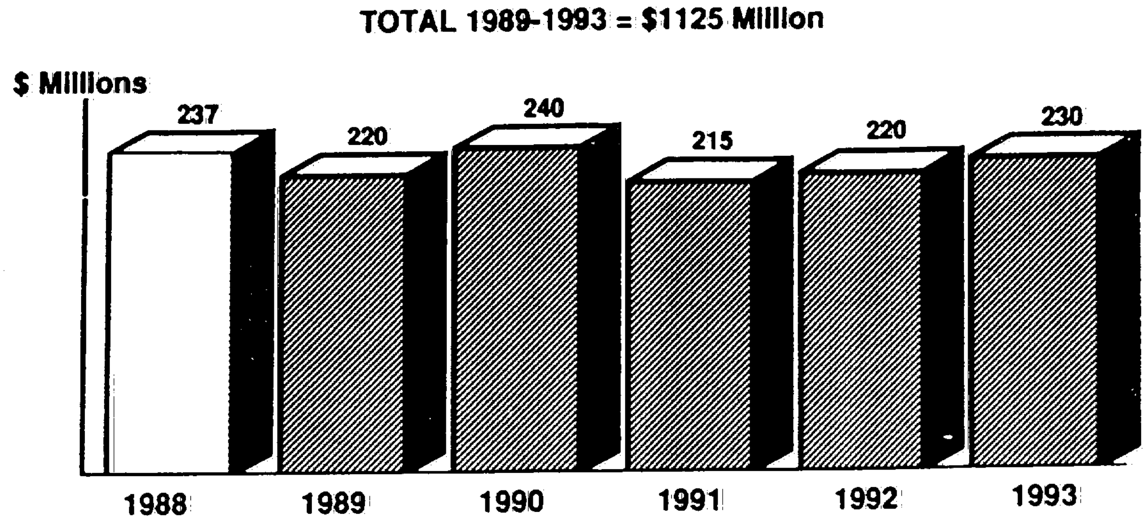
The overall strategies we have been following are working. Our focus will be on strengthening our execution of these strategies and executing a turnaround in coffee. The five-year plan is deliverable although it is unavoidably dependent on successful development results and success in coffee as we move to improve the alignment of our product portfolio with consumer trends. The areas most at risk in this plan are: Coffee, where significant share growth and income from operations improvement is projected; Cereals, where we lost share in 1988; and Shelf-Stable Meals, where the commericalization challenge is proving to be significant.

GF USA is pursuing activities in several areas which may improve the risk profile of this plan or improve results. Areas of opportunity include.....

- Marketing and sales execution
- Further productivity gains
- Kraft opportunities
- Acquisitions

GENERAL FOODS USA FIVE-YEAR PLAN

CAPITAL EXPENDITURES



General Foods USA will invest $1125 million in capital over the next five years. Spending is focused on the expansion of refrigerated desserts, completion of the third cereal production site, bakery automation and the commercialization of shelf stable foods. In addition, moderate investment will be made behind several key development programs designed to extend existing trademarks and product categories (e.g. Minute microwave side dishes). Capital spending from development projects will be phased in relationship to marketplace data to minimize risk.

Major Areas of Spending	Cumulative 1989 - 1993
Third Cereal Plant	$ 48 million
Shelf-Stable Foods	44
Ready-To-Eat Desserts	42
Bakery Automated Systems	40
Shelf Stable RTE Pudding	21

Cereals spending is directed at completing the Jonesboro production site and installing equipment for one new cereal production process. Additional production capacity can be accommodated within the Jonesboro site but has not been funded at this time.

Shelf-stable foods spending will provide production capability for the in-house manufacture or copack of microwaveable entrees and side dishes.

Ready to eat desserts capital will focus on maximizing the capacity at Mason City to support a larger base pudding business as well as out year copacker funds to roll out future line extensions.

Significant investment will be made in support of reducing the costs and overhead structure of the bakery business through the implementation of automated production and distribution systems.

Planned spending focuses on cost reduction opportunities, new product introductions and necessary replacement of existing equipment to support the manufacturing facilities.

GENERAL FOODS USA FIVE-YEAR PLAN

BAKED GOODS

OPERATING REVENUE			VOLUME AAGR	MARKET SHARE		INCOME FROM OPERATIONS		
1988	1993	AAGR	1988-93	1988	1993	1988	1993	AAGR
$883	$1184	6.0%	1.4%	N/A	N/A	$ 73	$121	10.6%

Strategies

- Maintain uncompromising product quality standards.
- Aggressively respond to changing consumer trends with innovative new product, packaging and merchandising programs.
- Increase the productivity of all operations and support systems across all baking companies while maintaining the highest product quality standards.

The General Foods Bakery Company generated $883MM in operating revenue in 1988, making it the fourth largest Fresh Bakery Company in the United States. Each of the three companies which comprise General Foods Bakery Company; Entenmann's, Oroweat and Freihofer, enjoys a strong franchise position in the markets where it competes. Entenmann's is America's premier baker of fresh premium sweet goods with significant positions in the Northeast, Florida, Midwest and California. Oroweat is a leading baker of premium variety breads operating in the West, Northwest and Southwest. The Charles Freihofer Baking Company complements Entenmann's in the Northeast with quality bread and cake franchises in the New York and Connecticut market areas.

Consumer trends to more healthful eating have stimulated the variety bread business but have negatively impacted sweet goods trends in established markets. Entenmann's is responding aggressively to the sweet goods challenge through a number of programs. A new line of cholesterol free sweet goods is being developed. In addition to being cholesterol free, the new products are less than 100 calories per serving and are totally consistent with Entenmann's commitment to delivering uncompromised quality as the primary operating strategy for the business. This new product line will be expanded broadly in 1989. In addition to the new product line, tropical oils have been eliminated from the entire line of Entenmann's products. Programs to increase cookie sales, develop single serve sweet goods, and increase foodservice distribution are also being pursued. These programs take advantage of consumer trends which favor portion controlled packaging, increased snacking behavior and positive sweet goods consumption trends away from home.

The Entenmann's product line was successfully expanded to Northern California in 1988. Boboli, our unique premium Italian bread product, was expanded to Southern California in 1988 and will be expanded to all Oroweat markets early in 1990. Freihofer has been successfully integrated into the GF Bakery Company and first year operating earnings were on target.

Significant progress has been achieved in identifying specific opportunities to restructure costs and increase productivity across the three bakery companies. Intensive reviews of bakery operations, administrative support and financial systems was completed in 1988 and programs to increase productivity are being initiated in each area. A thorough review of merchandising and route sales costs is currently underway with expectations that additional opportunities to improve productivity will be identified.

GENERAL FOODS USA FIVE-YEAR PLAN

CEREALS	OPERATING REVENUE			VOLUME AAGR	MARKET SHARE		INCOME FROM OPERATIONS		
	1988	1993	AAGR	1988-93	1988	1993	1988	1993	AAGR
	$631	$990	9.4%	2.9%	12.5	13.2	$ 67	$145	16.7%

Strategies

. Central Theme: Seek and sustain "High Taste" position, real and perceived.

. Estab. Brands: Achieve/maintain High Taste within respective market segments.

. New Products: Enhance the portfolio and pursue new segments, driven by High Taste benefits, utilizing available capacity near term.

Post Cereals had a difficult 1988, with share of market, volume and earnings below expectations. This reflected escalation in competitive spending, weakness on established adult brands, and mixed performance on new products (Post Oat Flakes successful; earlier entries below plan). Importantly, 1988 is a continuation of a 20-year trend of share decline. Assessments indicate the need for greater consistency of action over time against a more focused strategy across both established and new entries. Also, expertise and business system capabilities must be enhanced to be more competitive.

A "High Taste" theme will guide Post's established brand improvements and will focus new product activity. This theme will require taste preference vs. each product's segment competitors, and will include product delivery, appetite appeal, and perceptions defined by marketing imagery. Nutrition/wholesomeness will be delivered at fully competitive levels and the point of competitive differentiation for Post Cereals will be taste. Actions include the following:

- Established brands: Primary thrust is image enhancement through improved marketing, since actual product quality is generally fully competitive. Fruit & Fibre is a major exception, where competitive new products have outmoded this 1982 entry; a major improvement has been identified and will be introduced nationally in mid-1989.

- Development: New products continue to drive market growth; Post has improved its activity level and is now able to support 2 to 3 entries per year. Results must be improved. Planned introductions include additional oat products, and a "Family Presweet" entry, the fastest growing segment where Post does not now participate. Additionally, a major technical thrust is new fruit forms that can deliver superior eating characteristics, seeking sustainable competitive advantage.

- Business Expertise and Capability: Sales resources will be increased in early 1989 to correct the current competitive disadvantage in retail effectiveness, especially shelving/merchandising. The late-1988 restructuring of the marketing function should lead to greater expertise and resource continuity. Finally, manufacturing programs will ensure adequate capacity (Jonesboro plant) and improve packaging quality and costs (Battle Creek Material Handling Center startup - 9/89).

These corrective actions and greater focus are expected to lead to share stabilization versus historic declines. While a growth plan has also been developed, it is not a reasonable planning projection at this time and will be revisited when greater consistency of performance is demonstrated. Actions of the current plan and the growth plan are consistent during the next 12-18 months.

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General Foods USA Five-Year Plan

Desserts

	Operating Revenue 1988	Operating Revenue 1993	Operating Revenue AAGR	Volume AAGR 1988-93	Market Share 1988	Market Share 1993	Income from Operations 1988	Income from Operations 1993	Income from Operations AAGR
PACKAGED DESSERTS	$340	$412	3.9%	(2.2)%	77	79	$133	$157	3.4%
READY TO EAT DESSERTS	57	266	36.2%	28.7%	N/A	N/A	(21)	41	N/A

Strategies

- Preserve and enhance the equity of the Jell-O trademark.
- Introduce new dessert and snack products which are well aligned with contemporary lifestyles and consumer trends.
- Structure the operating costs and supporting business systems of each major Desserts business consistent with the long term potential of the business.

The two principal Desserts businesses share the common heritage of the Jell-O trademark. Each business, however, operates in a distinctly different competitive environment and uses a different business system. Dry Desserts is sold by the Dry Grocery Sales organization and enjoys a strong relative share position versus direct competition. Ready-to-Eat Jell-O Desserts are being sold by the Oscar Mayer sales organization and are distributed in the refrigerated dairy case at retail Jell-O Ready-to-Eat Pudding is completing a national introduction, significantly revitalizing the refrigerated and dessert category.

Jell-O Packaged Desserts will be managed to maintain real earnings despite a forecasted long term volume decline for the packaged desserts category. A major restructuring of production capacity and manufacturing costs will be executed in 1989 to improve the long term cost structure of the business. Market volume trends will be mitigated by pursuing a series of low cost product innovations to bring new interest to the category. A program to enter the Shelf Stable Ready to Eat category is also being initiated to protect the Jell-O franchise and participate in this growth category. Packaged desserts are experiencing competitive pressures from aseptically packaged shelf stable products like Snack Pack (Hunts) and Del Monte. An initial evaluation of instant setting gelatin will be made in 1989 as a possible means to improving long term volume prospects for Jell-O gelatin.

Jell-O Ready-to-Eat Desserts will complete the successful national introduction of Jell-O Ready-to-Eat Pudding and introduce a lite pudding line extension in 1989. Consumer acceptance of Jell-O Ready-to-Eat Pudding has been outstanding and the business continues to project above initial expectations. A second flanker pudding line extension will be readied for introduction in 1990, and development work will continue on non-pudding desserts. A convenience store test is also underway as the first step in expanding the business beyond grocery stores. Capacity at the Masion City, Iowa plant is being expanded. A sixth line will be operational by the middle of 1989. Business support systems including production capacity and sales support are being continually evaluated for further expansion as the full potential of the Ready-to-Eat business is confirmed by sustained market results.

GENERAL FOODS USA FIVE-YEAR PLAN

BEVERAGES

	OPERATING REVENUE			VOLUME AAGR	MARKET SHARE		INCOME FROM OPERATIONS		
	1988	1993	AAGR	1988-93	1988	1993	1988	1993	AAGR
POWDERED SOFT DRINKS	$502.7	$489.3	(.5)%	(3.3)%	80.9	81.0	$119.2	$154.2	5.3%
READY-TO-DRINK	67.9	83.7	4.3%	(.2)%	14.0	15.1	(8.0)	7.7	N/A

PSD Strategies

- Preserve financial strength through effective cost and pricing management.
- Focus marketing support on areas of proven leverage and seek to reverse long term market declines.

RTD Strategies

- Extend current trademarks into shelf stable beverages.
- Manage costs aggressively, leveraging trademark marketing and integrating administrative support within existing Division framework.
- Pursue acquisition opportunities, focusing on trademarks and/or business systems.

The Beverage Division will deliver real earnings growth despite anticipated declines in the powdered soft drink market. Specifically, the Powdered Soft Drink market is dependent on innovation for growth. Given innovation's unpredictability, it is assumed the market will decline about 3% per year consistent with historic declines. Earnings will be protected through aggressive cost management while preserving quality, effective marketing and merchandising, and margin expansion through pricing consistent with inflationary trends.

While recognizing the market decline, we remain committed to finding means to grow our volume either through share growth or reversal of historical market trends. Strategies are unchanged versus last year and focus on each brand's key leverage area: Kool-Aid (kids and ethnic marketing), Crystal Light (health and fitness), and Country Time (best tasting lemonade). More fundamental change in growth is the goal of targeted development efforts that address barriers to use, including lack of convenience and wholesomeness imagery/perceived quality. One such example currently being tested is Kool-Aid Kool Shots, a five flavor line of liquid concentrates which provides economy, taste, and kid's fun plus greater convenience.

The Ready-to-Drink aseptic box market is now maturing. While we have achieved our expected #2 share status, our position is weaker than planned due to more intense competitive new product introductions/relaunches, increased trade spending, and an absence of industry pricing.

The aseptic business contemporizes our trademarks and provides a foundation for future expansion; thus, we are committed to strengthening our market position while at the same time bringing this business to profitability. Specific areas of focus are improved Kool-Aid Koolers kids marketing and restructured trade spending for better merchandising and distribution. Improvement in financial performance will result from major cost reductions (formulas, packaging, and further co-packer automation) and, over time, industry pricing at the rate of inflation.

GENERAL FOODS USA FIVE-YEAR PLAN

SHELF STABLE FOODS

	1989	1990	1991	1992	1993
Net Revenue	$ 6	$ 50	$121	$178	$228
Income (Loss) from Operations	(16.5)	(14.9)	(6.9)	3.2	14.6

Objectives

- To become a leading player in the emerging microwavable shelf stable food category by participating broadly in multiple segments with a range of trademarks.
- To develop sustainable new businesses generating net revenue of $250-300 million, with acceptable returns.

Key Strategies

1. Complete the development and validation of the Impromptu product line and peelable tray technology by (a) demonstrating commercial viability and (b) confirming market potential.
2. Accelerate the extension of the shelf stable portfolio into multiple product categories and trademarks.
3. Develop a facility/expansion plan which provides adequate capacity for testing and expansion while minimizing up front capital expenditures.

Microwavable shelf stable products are projected to evolve into a substantial food category. General Foods has the potential to be an important participant. Last year's plan was based solely on Impromptu entrees which are now being tested in about 7% of the U.S.; however, this year's is based on a shelf stable portfolio of products addressing the opportunity across multiple segments in this category. General Foods is well positioned to leverage our extensive dry distribution network and portfolio of trademarks. Specific programs that support this strategic plan are as follows:

- Validate the commercial feasibility of our production system before capitalizing the business. Achieving commercial cost targets is critical to the success of the program. Adequate progress towards these targets will be demonstrated before we expand the business. Specific milestones have been established and a judgment relative to this progress will be made at mid-year.

General Foods USA Five-Year Plan

Shelf Stable Foods

- Expand the breadth of the product line as quickly as possible. The size of the category will permit participation across multiple segments and the ability to compete broadly will provide the maximum flexibility to achieve adequate mass. During 1989, a new subline will be developed and tested.

- Leverage existing trademarks wherever possible. This category will become highly competitive. Utilization of existing General Foods/Kraft trademarks provides leverage for consumer trial and marketing economics. Adding an umbrella parent brand to Impromptu is being explored.

- Use a phased approach to capital investment and market introduction. Staging our geographic expansion limits our downside risk and also allows out-year plans to serve as a contingency for near-in shortfalls.

- Continue to explore external development options so that General Foods can supplement its current skills through relationships with copackers and/or suppliers which expedite the achievement of our objectives.

The other meals program discussed in last year's plan, Culinova, was withdrawn from the marketplace on January 23, 1989 marking the end of GF USA development efforts in short shelf life refrigerated meals. Despite strong consumer acceptance in its Manhattan test market, Culinova's expansion plans had been hampered by the need to develop an entirely new direct store distribution system. The recent Philip Morris acquisition of Kraft brought with it well developed refrigerated foods distribution capabilities as well as a separate and promising thrust into the refrigerated meals category under the Chillery brand. Following discussions between GF USA and Kraft, the decision was made to withdraw Culinova and use the learning from that experience to contribute to the successful launch of the Kraft line of products.

Separate and apart from the Shelf Stable Foods program, we are launching Minute Microwave side dishes into 70% of the U.S. in 1989. These enhanced rice and pasta side dishes are expected to achieve an ongoing share of 3-4%, adding $40 million in revenue and $8 million in incremental earnings to the Dry Grocery Unit by 1993.

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GENERAL FOODS USA FIVE-YEAR PLAN

MAXWELL HOUSE COFFEE CO.

Key Objectives

1. Build Maxwell House Coffee Co. share to 40%+
2. Achieve Maxwell House brand leadership
3. Build margins to 6.5%

Key Strategies

1. Rebuild share through product quality, consistent marketing support and new products
2. Improve margin mix of product portfolio by increased focus on higher margin products
3. Reduce costs and improve pricing realization

1988 results for the Maxwell House Coffee Co. were disappointing. However, share momentum was reestablished in the latter part of the year as Maxwell House Rich French Roast was expanded nationally and Maxwell House Filter Packs entered test market. December Quarter share was 35.9% versus 32.1% in the March Quarter of 1988. Major progress has been made in improving the quality of Maxwell House products whereby all brands are now at parity or superiority versus competition. The objective is to achieve competitive superiority.

This plan is focused on the actions necessary to restore the franchise and financial viability of the Maxwell House business and towards the objective of building the Maxwell House brand to be #1 in the U.S. market.

The operating environment is assumed to be challenging.

Total Coffee Market is expected to decline by 1.8% per year with improvement by 1993 in response to the increased level of industry market support. The soluble segment is expected to decline by 6.4% while R&G remains stable.

Green Coffee Prices are expected to remain in the $.95-$1.05 range with the assumption that the ICO Agreement will not be renewed in 1989.

The Competitive Environment is forecast to continue to be intense as roasters battle to hold volumes in a declining market. Folgers (P&G) is expected to drive for volume growth by line extending under the Folgers trademark, e.g., national expansion of Folgers Gourmet Supreme in 1989. Nestle is expected to expand Tasters Choice ground nationally in 1989 and complete the national expansion of Hills/MJB by 1990. Nestle share growth in R&G is offset by decline of the soluble segment resulting in a relatively flat share. Over the plan time frame, we expect to outpace competition and grow share as a result of better ideas and superior execution. Projected market shares are:

	1988	1989(OB)	1993	Change (1988-1993)
MHCC	33.8%	36.9%	40.6%	+6.8pp
Folgers	29.2	31.3	31.8	+2.6
Nestle	19.0	19.8	19.2	+ .2

The achievement of the plan is driven by the three core strategies identified above.

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General Foods USA Five-Year Plan

Maxwell House Coffee Co.

Following is a summary of the key actions and the expected results in each of the three strategy areas:

1. Share and Volume Growth

A key priority in the plan is the achievement of share growth on the Maxwell House trademark through a combination of product quality and packaging initiatives, and development thrusts. The following are the key programs:

	Timing
Product Quality	
- Introduce RMH superior blend vs. Folgers	1989
- Convert decaf brands to AMCO. Market "taste like caffeinated"	1989-1990
- Introduce improved Maxwell House Master Blend product superior to Folgers	1988
Development	
- Launch Maxwell House Rich French Roast nationally	1989
- Launch Maxwell House 100% Colombian Supreme nationally (ex. West)	1989
- Test market and launch Maxwell House Filter Packs	1989
- Test market liquid coffee. Develop expansion plan	1990 (Test market)
Packaging	
- Introduce 26 oz/23 oz vacuum bag for RMH and Master Blend	1989
- Roll-out Maxwell House easy open can	1989-1990
- Test CEKA package for R&G and soluble coffee	1989-1990

As a result of these actions, Maxwell House brand share will grow and achieve leadership over Folgers by 1992.

Total volume will grow by .6% per year, thereby offsetting the negative impact of the total market decline and generating $11 million in income by 1993.

	Income From Operations			
	1990	1991	1992	1993
Share Growth	$ 8	$16	$24	$32
Total Market Decline	(6)	(12)	(17)	(21)
	+$ 2MM	+$ 4	+$ 7	+$11

2. Improved Product Mix

There are three key components driving the improvement in mix. In total, these increase total profitability by $55 million in 1993.

- Development Product Margins - Introduction of new products with higher variable margins than base Maxwell House brands ($35 million). Maxwell House filter packs contribute about half of the total.
- Base Brand Mix - Aggressive share growth of the higher margin soluble and decaf brands to partially offset market decline ($12 million).
- GF International Coffee Brand Growth - Volume growth of 5.4% per year through introduction of line extensions and sublines ($8 million).

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3. Margin Improvement Through Cost Reduction

A major cost improvement program is currently being implemented. It is driven by the need to scale both the fixed and variable cost structure to the size of the business and competitive realities. Fixed cost reductions have been made via both the 1987 and 1988 programs. In addition, there are a number of actions that we will take to improve net realization, achieve marketing efficiencies, and reduce variable costs.

	Income From Operations			
	1990	1991	1992	1993
1987 Restructuring Program	$ 4	$11	$11	$11
1988 Restructuring Program	15	15	15	15
AMCO Conversion Cost	7	9	9	9
Blend Cost Improvements	2	8	8	8
Improved A&C Efficiency	--	5	8	10
Others	(8)	2	16	27
Total	+$20MM	+$50	+$67	+$80

In summary, the combination of share growth, product mix improvement and cost reduction program will improve Maxwell House Coffee Co. income by $146 million from 1989 to 1993. This is partly offset by $5 million negative impact from environmental changes. This will result in an income of $100 million in 1993.

	Income From Operations Inprovement Vs. 1989			
	1990	1991	1992	1993
Share/Volume Growth	$ 2	$ 4	$ 7	$11
Improved Product Mix	23	33	48	55
Cost Reduction	20	50	67	80
Other	8	3	(2)	(5)*
Total Income From Operations Improvement	$53	$90	$120	$141
Absolute Income from Operations	$12	$49	$ 79	$100

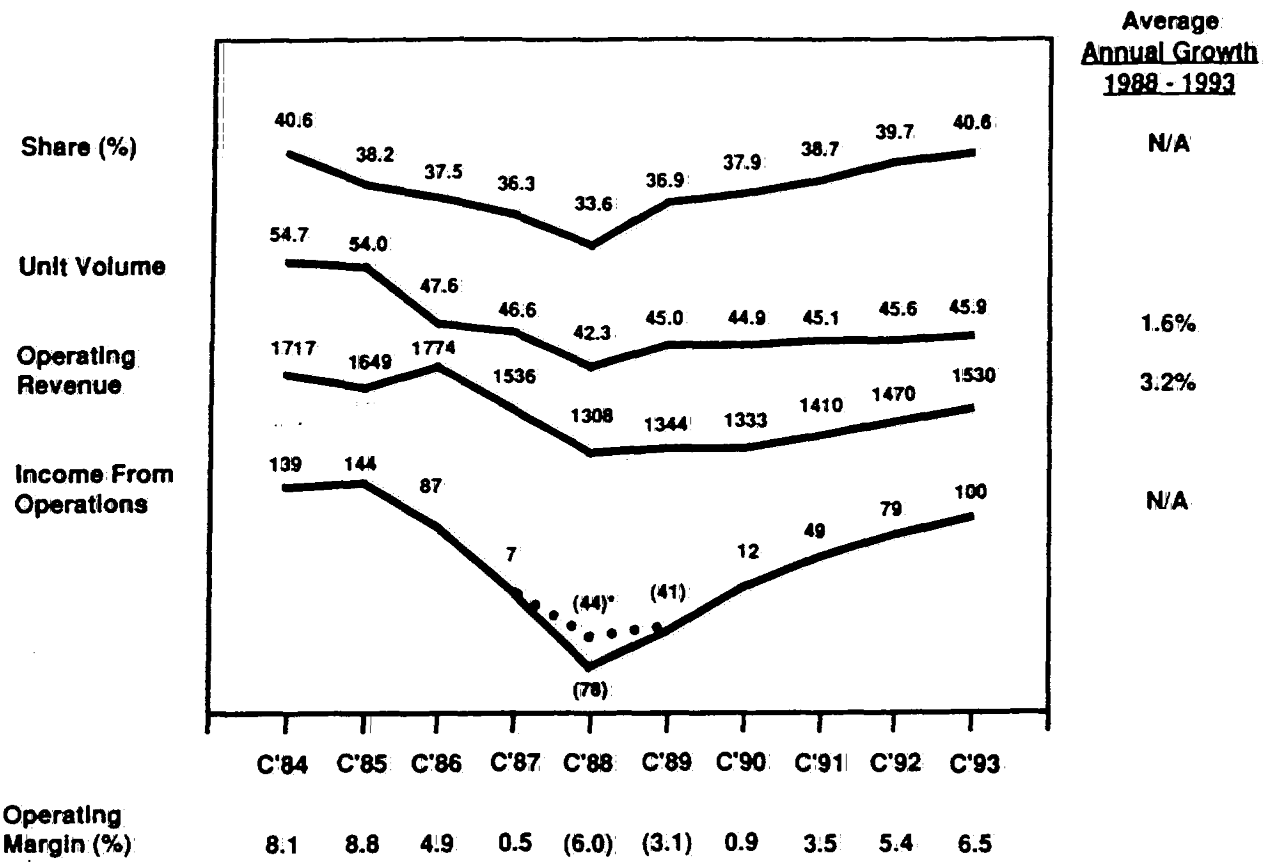
* Soluble ratio decline $(14), narrower green differential $9.

These actions result in the following projected franchise and financial profile over the next five years.

GENERAL FOODS USA FIVE-YEAR PLAN

MAXWELL HOUSE COFFEE CO.

KEY FINANCIAL TRENDS (IN MILLIONS)



***Operational income from operations excludes low green adjustments.*

This plan is a recovery plan for Maxwell House Coffee Co. and represents the path which we need to take in order to attain financial viability and clear market leadership. 1989 is a critical year as many of the key programs will be executed this year giving us a good reading on the achievability of this plan.

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GENERAL FOODS USA FIVE-YEAR PLAN

FOODSERVICE

	OPERATING REVENUE			VOLUME AAGR	INCOME FROM OPERATIONS				
	1988	1993	AAGR	1988-93	1988	1989	1990	1993	AAGR
TOTAL FSPD	$335	$408	4.0%	1.0%	$ 30	$ 23	$ 20	$ 46	8.8%
BEVERAGES	259	345	5.9	6.3	22	17	14	39	12.1
FOOD & DESSERTS	73	62	(3.2)	(7.0)	9	6	6	6	(7.5)

U.S. FSPD sells beverages and food products to food service distributors for sale to the food service industry. Beverages (coffee, juices, tea) account for 77 % of revenue and are sold through 150 narrow line distributors, while the food and dessert brands are sold through 2500 full line distributors.

As a result of the Kraft merger, we expect that there will be a significant backlash from our current customers and a reduction in our volume and income during the 1989-90 period. This is recovered in the out years as we place increased emphasis on beverage selling and proprietary equipment placement and service capability, more competitive coffee pricing, and the selective expansion of the distributor agency agreement concept. The food and desserts volume and income declines as the initial losses among the 2500 full line distributors are not recovered through the 47 Kraft houses and 8 GF branches. The plan assumes modest incremental volume through the Kraft houses in categories where GF currently has no food service presence, e.g., cereals, pasta, rice, frozen vegetables.

In addition to the focus on beverages, a number of potential areas of synergy with Kraft distribution are being assessed. These include strengthening GF brands in open distribution, moving Kraft private label volume to GF brands, as well as utilizing excess GF plant capacity for packing Kraft private labels. We expect that these will result in near term volume and cost opportunities which could reduce the negative impact of the distributor backlash.

Key Programs

- Implement beverage growth initiative
  - 40 additional field beverage specialists
  - 15 additional distributor agency alignments
- Expand proprietary equipment placement programs for coffee, juice, tea, and powdered soft drinks
- Launch new coffee products including Maxwell House Rich French Roast, Maxwell House Colombian Supreme, Maxpax vending system, Liquid coffee
- Reduce overheads by $6 million
- Pursue FSPD/Kraft synergy opportunities

General Foods USA Five-Year Plan

Comparative Statement of Operations

($ In Millions)

	1988 ACT	1989 OB	1990	1991	1992	1993	CAGR 1988-93
Weighted Volume	280.5	279.7	283.3	288.9	295.8	302.5	1.5%
Net Sales	$4950.0	$5133.5	$5334.6	$5672.7	$6034.3	$6418.3	5.3%
Royalties	4.6	1.3	0.8	0.9	0.9	1.0	
Operating Revenue	4954.6	5134.9	5335.4	5673.6	6035.2	6419.3	5.3
Variable Cost of Sales	2094.4	2150.9	2101.0	2223.0	2359.7	2502.5	3.6
Shipping Expense	175.7	178.4	189.6	207.7	221.5	237.2	6.2
LIFO Adjustment	21.3	(7.8)	3.3	3.5	6.3	5.2	
Marginal Contribution	2663.2	2813.4	3041.5	3239.4	3447.7	3674.4	6.6
Fixed Manufacturing Costs	451.6	447.1	471.4	493.9	512.7	539.7	3.6
Available Profit	2211.6	2366.3	2570.1	2745.5	2935.0	3134.7	7.2
Marketing & Selling	1645.6	1727.8	1839.3	1922.9	2014.5	2126.0	5.3
General & Administrative	171.2	159.9	169.9	181.2	191.2	203.4	3.5
Research & Development	67.8	63.1	64.9	67.1	69.7	72.1	1.2
Currency Translation	(0.1)	-	-	-	-	-	
Other Expense/(Income)	2.5	(10.1)	(8.0)	(5.2)	(8.7)	(10.5)	
Equity Earnings	(0.3)	(0.3)	-	-	-	-	
Income from Operations	$324.3	$425.3	$504.0	$579.5	$668.3	$743.7	18.0%

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KRAFT GENERAL FOODS
GROUP: GENERAL FOODS USA
MANAGEMENT INVESTMENT

($ MM)

	1988	1989P	1990	1991	1992	1993
NET RECEIVABLES	403	416	425	448	473	504
NET INVENTORIES	576	557	546	569	594	619
PREPAID EXPENSES	25	34	33	29	26	25
NOTES PAYABLES	1	3	3	3	3	3
A/P & ACCRUED LIABILITIES	593	497	459	455	469	485
WORKING CAPITAL	410	507	542	588	621	660
NET PROP, PLANT & EQUIP	1,602	1,677	1,769	1,823	1,862	1,900
INV & ADV TO UNCONS SUBS	10	6	(15)	(48)	(75)	(102)
TOTAL Y/E MANAGEMENT INVESTMENT	2,022	2,190	2,296	2,363	2,408	2,458

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GROUP: GENERAL FOODS USA
CASH FLOW STATEMENT

($millions)

	1988	1989	1990	1991	1992	1993
Source/(Use) of Funds						
Income From Operations	$324	$425	$504	$580	$668	$744
Income Taxes	123	162	192	220	254	283
Net Income	201	264	312	359	414	461
Add: Net Corporate Assessments	0	0	0	0	0	0
Net Income Before Corporate Assessments	201	264	312	359	414	461
Amortization	0	0	0	0	0	0
Depreciation	127	137	148	158	167	175
Deferred Taxes	0	0	0	0	0	0
Change in Accounts Receivable	(33)	(13)	(9)	(23)	(25)	(31)
Change in Inventory	68	19	11	(23)	(25)	(25)
Change in A/P & Accrued Liabilities	47	(96)	(38)	(4)	14	16
Change in Income Taxes Payable	0	0	0	0	0	0
Other, net	(70)	27	(9)	35	29	28
Funds from Operations	340	338	415	502	574	624
Capital Expenditures	(241)	(224)	(241)	(215)	(220)	(230)
Other Invest & Acquis, net of Divest	0	20	1	2	1	1
Free Cash Flow	99	134	176	289	355	395
Long Term Debt Retired	0	0	0	0	0	0
Net Interest Expense(After Tax)						
Corporate Assessment(After Tax)						
Reduction of Untendered Kraft Stock						
Financing Provided	0	0	0	0	0	0
Change in Intercompany Account	$99	$134	$176	$289	$355	$395

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KRAFT

Kraft USA

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of Kraft USA's forecasted food industry environment.

KRAFT USA

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KRAFT U.S.A.
1989-1993 STRATEGIC PLAN

KRAFT U.S.A. PLAN OVERVIEW

The Kraft U.S.A. Strategic Plan reflects an overall commitment to accelerated growth in Tonnage and Operating Income. Kraft U.S.A. is comprised of two major operating units, the Refrigerated Products Group (RPG) and the Grocery Products Group (GPC), as well as four key functional support groups, the Technology Group, the Operations Group, the Retail Sales Group, and the Consumer Marketing Services Group.

There are five Kraft, Inc. corporate strategies which guided the development of the Kraft U.S.A. Strategic Plan. First,, in all aspects of our business we are attempting to find, develop, and maintain sustainable competitive advantages. This has led to numerous product improvement programs, substantial efforts to develop superior advertising, ferocious defense of areas where we have established advantages, new product/line extension programs which are in line with consumer trends and which leverage established Kraft equities, and major functional advantage initiatives (Technology - Fat Replacement, Operations - Productivity, Retail Sales - leveraging programs).

Second, in all of our businesses we are attempting to move towards value-added products and services. We are adding value through product technology, packaging, and a variety of functional leveraging programs.

Third, we are augmenting our core business growth with strategically grounded New Business Initiatives. In some cases, we are extending trademarks into high priority core categories (i.e., Kraft Versatile Side Dishes, Philadelphia Brand Cream Cheese Slices). In other cases, we are undertaking higher risk, but still strategically grounded, incremental volume initiatives (RPG Chilled Foods program, the Kraft Fat Replacement program, the GPG Shelf Stable Microwave Meals program). We are also maintaining an active profile on the acquisition front in both a proactive and opportunistic fashion.

Fourth, we are committed to maximizing productivity. Throughout the business system we are actively pursuing the lowest imaginable costs at the desired product quality. Equally important, where appropriate, we are also trying to add value in order to get better performance at a lower cost.

Fifth, we have been and will continue to be organizationally flexible. We are continuing to evolve the organization to meet the ever-changing demands of the competitive environment. We will continue to secure top talent and provide superior rewards for superior performance. Finally, we will continue to enhance management skills across all functions to insure optimal competitiveness on a sustaining basis.

These five strategies are the fundamental building blocks upon which the Kraft U.S.A. Strategic Plan is built. Importantly, these strategies and the resultant plans have enabled us to confidently set aggressive long range quantitative goals over the planning horizon.

As indicated in the following chart, the two major operating units (RPG and GPG) account for virtually all of Kraft U.S.A.'s tonnage (99% of 1989 Plan) and Operating Income (92% of 1989 Plan). The All Other column includes a variety of miscellaneous initiatives including but not limited to: the Kraft Citrus business, Operations Productivity Program, Kraft brokerage income for Pillsbury Refrigerated Products, and the Corporate Fat Replacement Program. The All Other column has not yet been broken out prior to 1987 due to the complexity of restating the revised numbers along the lines of the newly created KGF operating units.

KRAFT U.S.A.
OPERATING GROUP STRATEGIC PLAN HIGHLIGHTS

	GPG		RPG		TOTAL GPG & RPG		ALL OTHER		TOTAL KRAFT USA	
YEAR	TONNAGE (MM LBS.)	OPERATING INCOME (MM $)	TONNAGE (MM LBS.)	OPERATING INCOME (MM $)	TONNAGE (MM LBS.)	OPERATING INCOME (MM $)	TONNAGE (MM LBS.)	OPERATING INCOME (MM $)	TONNAGE (MM LBS.)	OPERATING INCOME (MM $)
1983	1666	168	974	172	2640	340	NA	NA	NA	NA
1984	1607	205	959	187	2566	392	NA	NA	NA	NA
1985	1648	252	960	219	2608	471	NA	NA	NA	NA
1986	1646	279	995	246	2641	525	NA	NA	NA	NA
1987	1696	257	1068	297	2764	554	155	2	2919	556
1988	1713	261	1112	278	2825	539	115	19	2940	558
CAGR 1983-88	.6%	9.1%	2.7%	10.0%	1.4%	11.7%	NA	NA	NA	NA
CAGR 1985-88	1.3%	1.2%	5.3%	9.0%	2.8%	4.8%	NA	NA	NA	NA
AGR 1987-88	1.0%	1.6%	4.1%	(6.4%)	2.2%	(2.7%)	(25.8%)	+++	.7%	.4%
1989	1727	336	1121	401	2848	737	10	57	2858	794
1990	1803	358	1162	419	2965	777	10	60	2975	837
1991	1858	390	1219	443	3077	833	11	70	3088	903
1992	1874	425	1273	499	3147	924	12	97	3159	1021
1993	1896	471	1369	580	3265	1051	14	116	3279	1167
CAGR 1988-93	2.1%	12.6%	4.1%	15.8%	3.1%	14.3%	(17.6%)	43.6%	2.3%	15.9%
CAGR 1989-93	2.4%	6.7%	4.1%	7.6%	3.3%	7.1%	6.7%	17.3%	3.5%	10.2%

As indicated above, the Operating Income for Total GPG and RPG will grow at a CAGR of 14.3% 1988-93, compared to a growth rate of 11.7% 1983-88. The key challenge is to achieve the 1989 target of $737MM (+36.7%). This will be accomplished through a combination of pricing, productivity, tight expense control and modest tonnage growth. Once the aggressive 1989 target is reached, we will continue to build Operating Income at a CAGR of 7.1% from 1989-93.

Tonnage for Total GPG and RPG is planned to grow at a CAGR of 3.1% 1988-93. This is more aggressive than the historical growth pattern, although 1985-88 tonnage grew at a 2.8% CAGR. The more aggressive tonnage growth profile reflects continued modest growth in the existing grocery and cheese categories augmented by the successful execution of the Fat Replacement Program across both RPG and GPG, the Chilled Foods initiative in RPG, and the Versatile Side Dish and Shelf Stable Microwave Meal programs in GPG. Importantly, none of these initiatives are planned to contribute significant Operating Income over the 1988-93 planning horizon. Therefore, should any one of them falter, the impact on Operating Income would be negligible. In fact, on the positive side, each one of the projects offers significant upside potential for Operating Income. Finally, the Operating Income growth in All Other reflects the successful execution of the Kraft Productivity program. This Operations Group driven program accounts for virtually all of the Operating Income growth over the planning horizon.

The following chart provides additional financial perspective on Kraft U.S.A. Operating Revenues will increase on the strength of tonnage growth/mix and pricing. Return on Sales increases +6.8 pts. over the planning horizon, however, 4.5 pts. are planned to be achieved in 1989 as a result of the numerous initiatives being under-

taken to improve Operating Income near term. ROMI improves in a similar manner. Capital Investment increases primarily as a result of the Fat Replacement and Chilled Foods initiatives.

KRAFT U.S.A. STRATEGIC PLAN

YEAR	TONNAGE (MM LBS.)	OPERATING REVENUES (MM $)	OPERATING INCOME (MM $)	RETURN ON SALES	ROMI	CAPITAL INVESTMENT
1987	2919	$3849	$556	14.4%	60.5%	$62
1988	2940	4114	558	13.6%	64.1%	75
87-88	0.7%	6.9%	0.4%	(0.8) pts.	3.6 pts.	21.0%
1989	2858	4396	794	18.1%	78.2%	102
1990	2975	4643	837	18.0%	78.4%	119
1991	3088	4962	903	18.2%	77.4%	132
1992	3159	5264	1021	19.4%	81.2%	115
1993	3279	5720	1167	20.4%	83.1%	151
CAGR 88-93	2.2%	6.8%	16.1%	6.8 pts.	19.0 pts.	16.2%
CAGR 89-93	3.5%	6.8%	10.2%	2.3 pts.	4.9 pts.	11.2%

Finally, a source of change analysis clearly helps identify the key profit drivers. In order to provide a relevant historical perspective, we will focus on the source of change for Total GPG and RPG.

SOURCE OF CHANGE ANALYSIS

	Total GPG and RPG		Kraft U.S.A.
	1983-88*	1988-93	1988-93
• Tonnage/Mix	$206MM	$ 320MM	$ 323MM
• Pricing	516	1013	1131
• Cost of Sales**	(131)	(420)	(431)
Available Profit	591	913	1023
• Marketing Expense (includes Advertising, Deals, Coupons)	(322)	(364)	(374)
• Other Expenses	(70)	(37)	(40)
Total Profit Change	$199MM	$ 512MM	$ 609MM

*1983-88 Source of Change Analysis for Total GPG and RPG is based on estimated restatements into the Philip Morris reporting format.

**Cost of Sales includes variable cost, shipping expense, and manufacturing expense.

As indicated above, pricing will continue to be the primary profit driver. Marketing expenses will continue to increase as we aggressively expand and defend our current market positions, and as we launch major new business initiatives. Finally, all other expenses will be tightly managed throughout the planning horizon.

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Overall, the Kraft U.S.A. Strategic Plan is ambitious but achievable. There are four fundamental keys to success. First, we need to make the planned quantum leap in profitability in 1989 without jeopardizing our short term or long term market positions. Second, we need to continue to build and defend our core grocery and cheese businesses by continuing to build competitive advantages and by adding-value. Third, we need to successfully execute our key new business initiatives, especially Fat Replacement, Chilled Foods, and Versatile Side Dishes. Fourth, we must successfully execute our key functional initiatives, particularly the Operations Group Productivity Program and the Retail Sales leveraging programs. We have the plans in place to succeed on all four dimensions, the challenge before us is to continue to refine our strategic thinking and to flawlessly execute the resultant plans.

The balance of this narrative document will provide an overview of the Strategic Plans for both of the major operating units, the Refrigerated Products Group and the Grocery Products Group, as well as brief highlights of the Strategic Plans for the Technology Group, the Operations Group, and the Retail Sales Group.

REFRIGERATED PRODUCTS GROUP

PLAN OVERVIEW

The 1989 Strategic Plan for the Refrigerated Products Group (RPG) affirms our commitment to continued growth in both tonnage and operating income. In order to reach our goals, RPG must lead in adding value to our products and business systems. RPG believes that the strategies and programs planned will enable us to achieve superior returns in an increasingly competitive environment.

The Plan leads to total RPG tonnage of 1.4 billion pounds, net sales of $3 billion and operating income of $580 million in 1993, with compound annual growth rates 1988-93 of 4.3%, 7.5% and 15.8% respectively. It is important to note that these numbers reflect significant investment in our Chilled Foods business initiative. Our total cheese business (core cheese and acquisitions) shows tonnage of 1.3 billion pounds, net sales of $2.6 billion and operating income of $567 million in 1993, with compound annual growth rates 1988-93 of 2.5%, 5% and 14.5% respectively.

1989-93 OBJECTIVES AND STRATEGIES

RPG's strategic objective is to be the leading refrigerated food company in the U.S. with sustainable annual growth of 5% in tonnage and 6% real operating income. RPG's plans to achieve this objective are build around our two business areas, Cheese and Chilled Foods. These businesses will be discussed separately below.

CHEESE STRATEGY

RPG's fundamental goal is to build and protect the cheese business. The strategies to accomplish this goal are:

- Better differentiate products
- Introduce new consumer based products
- Ferociously defend
- Utilize sales leverage
- Aggressively pursue cost and asset reduction programs
- Exploit new channel opportunities
- Achieve technology leadership position
- Pursue acquisitions to fill identified strategic needs

The focus of these strategies is to maintain and, importantly, build the sustainable competitive advantage inherent in RPG's cheese business.

Since 1983, RPG has successfully differentiated our products. Advertising campaigns such as "5 oz. of Milk" on Singles, "Half the Calories" on Philly and "Microwave

Chees Whiz" have proven to be effective business building programs. Current efforts such as "Thicker Sauce" on Grated and "Best Melting Cheese" on Velveeta continue our efforts in the advertising area.

Packaging has also proven to be a successful means of differentiating our products. Historically, our work has focussed on improved graphics. Our major efforts for the future will attempt to bring added convenience to our products. Examples of this work include Ziplock Slices, Fold Tight Shreds and Cheez Whiz Zap-a-Pack. We believe this area offers significant business building potential.

New products are a major source of new value creation for RPG. Our high shares and overall category leadership position make new products a necessity for RPG's continued superior growth versus competition. First, we will focus our efforts on "success". It is probable that we will have fewer new product introductions in cheese, but we will have higher potential new products. Second, we will focus on extending our existing franchises rather than creating new brands. Finally, we will concentrate our efforts in two key areas, healthy cheeses and convenience. Healthy cheeses represent a major new opportunity. Convenience is an opportunity area for new products and also a means to strengthen our existing franchises.

In executing against these themes over the 1989-93 period, our Strategic Plans reflect our efforts to continue to provide adequate support behind our mainline brands, as well as continue to invest in programs or line extensions that extend existing brand equities and fulfill recognized consumer needs for taste or convenience. Overall, we expect 2.7% average annual tonnage growth and 13% average annual income growth (excluding KPP) from our core branded cheese business over the plan horizon. Including the effects of all productivity programs associated with the core cheese business, we're expecting average annual profit growth of 15%.

Highlights of efforts across our major product categories are as follows:

In the Sandwich category, in addition to continuing to support our existing Singles copy, we will pursue new value added positionings (e.g. anticariogenicity and sandwhich nutrition), while benefiting from test markets and/or expansion of Extra Thick, "Cheddar Mozzarella," and "Cream Cheese" slices. Finally, we will be benefiting from a repositioning of Deluxe Slices ("preferred Cheddar taste" claim). All of these initiatives are key to further developing or enhancing our value added positioning in an increasingly competitive category. We are assuming that the intense competitive environment we've experienced over the past several years (Bordon, County Line, and Lake to Lake) will continue unabated, requiring us to maintain our strong defensive programs that enable us to retain or build our share of the category.

In the Recipe category, we will initiate efforts to improve the functionality and convenience of mainline Velveeta Loaf, and will be expanding Cheez Whiz "Zap-a-Pack", Velveeta "Cheese Sauce" and Velveeta Shreds. We will also work to develop and leverage Velveeta umbrella advertising. Additionally, we will continue to test and pursue the upside potential of Grated Parm by positioning it as an ingredient rather than a topping cheese.

In our Natural Cheese category, we will have two major areas of focus. First, we're committed to regaining the offensive against Sargento Shreds. Sargento has been successful at achieving a more value added positioning in the fast growing shreds segment by offering the consumer benefit of Zip-Lock packaging.

As a result, although our 100% Natural Shreds have shown above average growth (+9% in 1988), we've lost share to Sargento. Additionally, while we've developed our own

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packaging innovation, Fold Tight, which we believe to be superior to Zip-Lock at delivering a meaningful consumer benefit of convenience and freshness, we've experienced manufacturing problems delaying the national expansion of Fold Tight.

Beginning in 1989, we'll be urgently pursuing the rollout of Fold Tight to two regions (Central and Great Lakes), and we're developing short term promotion programs designed to at least hold our current share of the segment until we achieve broad scale distribution of Fold Tight in 1990.

Secondly, the potential entry of Unilever/Shedd's into the cold pack/spreads segment poses a significant competitive threat to both our Naturals business, and more importantly, to our lucrative position in the cream cheese category. This new competitive threat, which is of particular concern to us following Shedd's success in the margarine category, has driven RPG to develop strong defense programs in both of the affected categories. We'll be re-examining our Cracker Barrel Cold Pack business to test its upside potential, as well as re-evaluate potential acquisitions to quickly fill any voids in our product line. Similar efforts will be pursued in the Spreads category to ensure that we're protected from encroachment in our cream cheese business as well.

On a more positive front, the Natural Cheese category will benefit from the national rollout of Kraft Light Naturals, and pursuit of the upside potential of String Cheese with advertising. Additionally, after two years of non-support behind Cracker Barrel, which has resulted in a precipitous decline in volume and share of this brand, we'll be repositioning Cracker Barrel Chunks with a launch of four new flavors and restoration of media support behind the brand.

Finally, in the Snacks and Spreads category, we will continue to support the "Half the Calorie" Philly campaign as well as other potentially more compelling messages against other spreads, including potential expansion of the Philly-Lender's advertising test. We will also be testing the microwavable Nacho Kit and sweetened Handi-Snacks, while continuing to develop product concepts in the spreadable, European style breakfast cheese segment, and potential entries in the microwavable cheese snacks arena.

Beyond our specific category programs, there are several division-wide objectives and programs that are an integral part of RPG's Strategic Plan. Importantly, virtually all of these programs are being actively pursued in 1989 and will be expanded as appropriate. Highlights of our division-wide programs are as follows:

Ferocious defense of our core cheese business will continue to be a top priority for RPG. The cheese business is RPG's fundamental asset, and we will not allow competition to impact the strength of this business. In recent years RPG has successfully defended against Sargento, County Line and Borden. Additionally, our Strategic Plan recognizes the aforementioned potential competitive threat posed by Unilever competing across two of our categories. Our plans are built assuming that defensive efforts equal to past levels will be necessary in the future. However, we recognize that the attractiveness of the cheese business makes future competition probable. RPG will adjust our plans to meet any competitive initiative.

Leveraging the strengths of the Kraft sales force continues to be a key strategy for RPG. During 1987-88, RPG worked with Sales on a project called the "Atlanta Test". The purpose of this study was to explore the potential of creating new selling techniques. The program has led to increased authorizations and increased sales in the Atlanta market (+5% on tonnage).

Additionally, we are in the process of rolling the concept into more Kraft markets. Based on the success of the Atlanta test, RPG is leading a second project to push RPG into the position of being recognized as the "Refrigerated Case Expert". The

early results of this project are encouraging. We see utilization of brand/sales leverage as a major force driving our future growth.

Another area we are exploring to utilize sales leverage is trade and consumer promotion. The size of our individual brands and the breadth of our cheese product line are a major difference between RPG and its competition. Our goal is twofold. First, we need to increase the impact of our consumer promotions. Second, we need to decrease our reliance of trade deals. Programs being tested include implementation of the Targeted Events Area Marketing (TEAM) concept and a "Total Fund" approach to dealing, plus major consumer promotions such as "Project S", a successful major premium event in 1988. If successful, these programs will change the basis of store-level competition to RPG's advantage.

On the productivity front, RPG has been successful in pursuing cost and asset reduction programs to improve ROMI. The Fort Knox program instituted in 1986 has lead to identified cumulative savings of $50 million through 1988. RPG's involvement in the KPP program is leading to accelerated realization of additional savings. As part of our Plan, we have included cumulative savings of $30 million in our 1989-93 financials. Additionally, productivity savings retained by O&T related to the cheese business will total approximately $100 million over the '89-'93 period.

Relatedly, Operations and RPG have worked together to develop an overall Procurement/Manufacturing Strategy for cheese. Execution of the strategy will likely further benefit RPG from both a cost and competitive advantage perspective over the 1989-'93 period.

Channels other than the retail grocery continue to grow as sales outlets for cheese. RPG intends to be the leader in these alternate channels. One of our subsidiaries, Churny, is our entry in the deli cheese business. With the acquisition of Purity in 1987, RPG moved into the leadership position for specialty cheese. Utilizing Churny's strengths of resources, sales/distribution system, mass and products we believe will lead to increased strength and returns in the deli channel. Similarly, our plans call for exploiting opportunities to increase RPG's core business through both convenience stores and mass merchandisers. We are working with Sales to develop programs and products (i.e. bulk sizes for mass merchandisers, single serve, immediate consumables for convenience stores) to meet the needs of these important channels.

Technology leadership is taking on an increasing importance for RPG as a source of value addition. Consumer trends to healthier, more convenient products have created both risks and opportunities for RPG's cheese products. Risks in the sense that our current products do not fit with these trends. Opportunities in that if RPG can change our existing products or develop new products to match these trends, we can significantly increase RPG's competitive advantage. Key areas of exploration include fat substitutes, analogs, casein fractionation, and packaging. Of particular note is RPG's participation in the corporate-wide pursuit of commercial application of fat substitute technology to our process slice and cream cheese categories (Trailblazer II). Our goal is to have new products in test markets in late 1989 or early 1990. Developing our technology position will require major investments, both time and financial, but RPG believes the investment is warranted given the potential return.

The final key elements of RPG's 1989-93 cheese strategic plans include our subsidiary cheese companies and acquisition strategies.

Our subsidiaries, Churny and Pollio, which have provided Kraft an excellent opportunity to participate in the higher growth Specialty and Italian Cheese segments, continued to perform well in 1988. We expect even better performance over the

planning horizon, with average annual operating income growth of 15%, well over expectations in our acquisition plans.

Through Churny and Pollio, RPG has proven that strategic acquisitions can add strength and value to the RPG portfolio. RPG will continue to pursue acquisitions in the cheese business to fill strategic needs. In general, our criteria are that the target company brings to RPG a strong brand equity, strong market position, unique products or manufacturing expertise. Additionally, RPG must be able to add value to the acquired company through such things as geographic expansion or lower costs. Due to RPG's size and expertise in the cheese business there are a very limited number of viable acquisition candidates in cheese. Two areas where acquisitions are probable are specialty cheese and west coast manufacturing capacity.

CHILLED FOODS STRATEGY

The second element of RPG's overall strategy is to establish RPG as the major U.S. marketer of Chilled Foods. Based on our work to date, RPG is convinced that Chilled Foods will be a major business in the U.S.

1988 was a pivotal year in the development and execution of RPG's strategy for establishing Kraft as the leading branded marketer of Chilled Foods in the U.S. During this past year, we initiated consumer tests of our major product entries ("Chillery" brand entrees, salads and desserts; DiGiorno fresh pasta and sauces) and expanded our "business system" test to include nearly 70 stores in the Kansas City market.

Our 1989 plans call for continued learning in Kansas City where our dedicated Direct Store Delivery/Sales/Merchandising business system is in place. 1989 also calls for the melding of consumer and systems learning in a new expansion market in third quarter, 1989.

Going forward, RPG's commitment to win in Chilled Foods requires that major investments be made in this area. In 1993, our Plan leads to net sales of $300 million and operating income of $13 million. By the year 2000, with a national business, Chilled Foods could attain $1 billion in sales and $150 million in operating income. The intervening years between 1989 and 1993 reflect significant investment. We believe that this level of investment is warranted for both offensive and defensive reasons. Offensively, Chilled Foods represent a major growth opportunity. RPG must lead in Chilled Foods if we are to attain our vision. Defensively, Chilled Foods must be pursued to ensure that Campbell's and Nestle's, among others, are attempting to develop chilled foods businesses. Success by any of these competitors will not only restrict the growth of RPG, but could provide these competitors with an opportunity to attack RPG's core cheese business. RPG will aggressively defend our core business.

RPG's basis strategy in Chilled Foods contains the following elements:

- Deliver superior product quality/value to consumers
- Invest in consumer/trade education
- Build proprietary business systems to support the products
- Lead/influence establishment of Chilled Foods category regulations

The focus of these strategies is to develop the potential of the Chilled Foods category and position RPG as the advantaged competitor.

Fundamentally, Chilled Foods will only succeed if they deliver superior product quality at an acceptable price to consumers. As such, our work in product development focuses on creating products that are superior to competitive alternatives. We have succeeded in creating superior Pasta and Sauces, Entrees, Salads and Desserts.

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Investment in consumer and trade education is important for two reasons. First, education will drive the growth in this category. Our research shows that consumers will enter the category once they understand the benefits inherent in Chilled Foods. RPG must take the lead in driving category growth. Second, investment spending by RPG will create a strong sustainable competitive advantage. The investment will position RPG as the leader in Chilled Foods and establish strong brand franchises for our products.

Proprietary business systems are necessary to enable RPG to deliver high quality, safe products to consumers. Areas of focus include technology, manufacturing, distribution, sales and merchandising. To date, we have made major strides in all of these areas. In technology and manufacturing we have developed a significant knowledge base in understanding how to produce safe products. We have developed a distribution and merchandising system that will hold products at less than 40° and capitalize on available synergies with Kraft Foodservice. Finally, we have created a separate salesforce to merchandise our products at store level.

The final area of strategy in Chilled Foods involves RPG playing a leadership role in establishing category regulations. Chilled Foods are a high potential area, but there are risks. The largest risk is product safety. Without strong technical research and stringent manufacturing and distribution controls, there is a high probability of unsafe product going to market. This risk is that the category could be destroyed by the introduction of unsafe products.

RPG will not place any products in market until they are proven safe through normal consumer usage patterns. To protect the category, RPG must ensure that other manufacturers adhere to the same high standards. RPG is taking an active role in the development of standards and practices for Chilled Foods products.

Overall, RPG remains committed to the development of Chilled Foods as a major new business area. Over the last two years we have learned a great deal about the technology, manufacturing, distribution and marketing of Chilled Foods. Based on this learning we believe that the investment to develop this new business is warranted by the market potential. RPG's plans will result in our leadership of the Chilled Foods category.

RPG FINANCIAL HIGHLIGHTS (in Millions)

							CAGR	
CONSOLIDATED RPG	1988	1989	1990	1991	1992	1993	83-88	88-93
Tonnage	1112	1121	1162	1219	1273	1369	2.7%	4.3%
Net Sales	$2073	$2247	$2340	$2490	$2670	$2978	3.4%	7.5%
Operating Income	$ 278	$ 401	$ 419	$ 443	$ 499	$ 580	10.0%	15.8%
ROMI %	48%	64%	65%	64%	66%	67%	+15.9 pts.	+19.6 pts.

Key assumptions that generally impact the 1989-93 financial plan include:

Tonnage

Our 1989-93 plan reflects overall annual cheese tonnage growth of +2.5%, and projects that we'll at least hold share in all major categories. Our overall growth rate is aggressive, particularly in relation to our 1983-88 annual growth rate of 2.6%, which included the benefit of acquiring Churny and Pollio in 1984 and 1986 respectively. These acquisitions accounted for over half of the average annual growth during the '83 to '88 period. However, the momentum developed in 1988 behind our core cheese businesses, combined with contributions from new products, fuels our expected '89-'93 growth. While aggressive, our new product contribution to growth is achievable, particularly when viewed with the perspective that we include the impact of several new initiatives launched in 1988 with demonstrated potential (e.g. Light Naturals, Zap-a-Pack).

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Pricing, Costs and Margins

The key drivers of increased profitability for RPG over the 1989-93 period include:

- Price realization -- our 1989-93 plan reflects the benefits of pricing actions taken in 1988, plus anticipated price increases in 1991-93.
- Declining Commodity Costs -- following the drought induced runup in cheese prices in 1988, we expect cheese prices to resume their long term decline, aided by anticipated reductions in dairy support prices in 1990 and 1991.
- Productivity -- as previously mentioned, we expect to realize well over $30 million in cost savings attributable to the cheese business during the 1989-93 period, with an additional $100 million in productivity savings related to the cheese business retained at O&T.

A key issue for RPG will be our ability to effect and hold our expected pricing actions vis-a-vis: declining cheese markets; widening price gaps versus competitors whose pricing follows the cheese market (e.g. private label); and increasingly more competitive categories. This underscores the importance of our ability to engage in meaningful product differentiation through adequate marketing support levels, packaging innovations, and new products in order to command our value added/premium price positioning in the marketplace.

Brand Support

Our overall brand support strategy is to maintain support at adequate levels behind programs that build the business, while investing in new products that are consistent with our basic strategies. Real advertising and consumer promotion increases are exclusively driven by support for new products and initiatives (Zap-a-Pack, Cheddar/Mozzarella, Velveeta Cheese Sauce, et al); we've grown support levels on core products only at inflation over the 1989-93 period. We are essentially holding trade spending at 1988 levels, while not explicitly providing for any major defensive funding behind our key brands in the event of any unusual competitive activities.

We've also provided incremental spending behind R&D, marketing and market research for fat substitute-related new products (Trailblazer II).

Profitability

Significant improvement in return on investment is envisioned for RPG over the 1989-93 period, fueled essentially by increased profitability (as measured by return on sales). With only slight improvement in asset utilization/turnover provided for in our Strategic Plan financials, our projected increase in return on sales from 14% in 1988 to 19% in 1993 drives the nearly 20 point improvement in ROMI to 67% by 1993. Achieving our 1989 Operating Plan growth of +40% will be the biggest hurdle in achieving this long-run improvement in profitability.

Cash Flow, Capital

Forecasted cash flow is consistent with our strong operating performance, with some dilution due to capital investments for cheese and chilled foods. For cheese, capital investments are approximately $40 million per year, in line with historical reinvestment rates, and include cost reduction-related investments as well as selected expansion opportunities. The Chilled Foods investment includes the addition of manufacturing capacity, as well as merchandising coolers, and distribution equipment to support an assumed regional expansion during the 1991-93 period.

Summary

In conclusion, as we head into 1989, RPG is well positioned to continue its record of strong growth in volume and profitability. Our major brands are healthy and we believe the strategies and programs we've outlined in our Plan bode well for aggressive, but achievable, growth beginning in 1989.

Attainment of our vision of U.S. leadership in refrigerated foods, both quantitatively and qualitatively, is an aggressive, but achievable, goal. RPG starts with a very strong base, the core cheese business. Our efforts are always focussed on building and defending the core cheese business. Chilled Foods show the potential to be a second strong base from which RPG can grow. Still, we recognize that RPG must improve and grow stronger, if we are to reach our vision. Execution of this Plan will, we believe, enable RPG to make significant strides towards attainment of our vision.

GROCERY PRODUCTS GROUP

PLAN OVERVIEW

The 1989 Grocery Products Group (GPG) Strategic Plan is aggressive but achievable. Overall, the Plan recognizes that 1988 was a year of stabilization and profit restoration following a difficult and disappointing 1987. The Plan for 1989 and beyond is built on four key premises. First, it is anticipated that the renewed vitality of some of the key core businesses in GPG will be maintained/enhanced (Barbecue Sauce, Traditional Dinners, Seven Seas, Marshmallows). Second, it is assumed that three troubled GPG businesses will experience meaningful turnarounds (Mayonnaise and Kraft Pourables tonnage and share, Tablespreads profitability). Encouragingly, major turnaround programs are in place for all three businesses with significant business improvements forecasted for each business in 1989. Third, it is assumed that GPG will successfully execute three highly focused, strategically grounded, new business initiatives - Versatile Side Dishes, Shelf Stable Microwave Meals, and Fat Replacement. Fourth, it is anticipated that GPG will be able to continue to successfully build profit margins through a combination of aggressive pricing, productivity, and tight expense control.

Overall, as the following chart indicates, GPG will increase tonnage at a CAGR of 2.1% over the 1988-93 planning horizon. This represents a more than tripling of the prior 5 year growth rate (0.6%) on the strength of the premises listed above. Net sales will increase at a 7.6% CAGR (versus 4.4% for the prior five years) as a result of tonnage growth, continued aggressive pricing, and improved tonnage mix. Operating Income will grow at a 12.6% CAGR (versus 9.1% for the prior five years) due to the strong unit Net Sales growth combined with strong productivity measures and tight expense control. ROMI will grow 35.2 pts. because of the strong operating income growth and prudent capital spending. Finally, Net Cash Generated over the 5 year horizon will exceed $1.1 billion, due to high GPG tonnage leveraged by high gross profit margins coupled with tight control over operating expenses.

TOTAL GROCERY PRODUCTS GROUP
STRATEGIC PLAN FINANCIAL OVERVIEW

YEAR	TONNAGE (MM LBS.)	NET SALES (MM $)	OPERATING INCOME (MM $)	RETURN ON NET SALES	ROMI	NET CASH GENERATED (MM $)	CAPITAL SPENDING (MM $)
1983	1665.9	$1142.2	$168.0	14.7%	91.0%	$115.8	$9.6
1984	1607.1	1266.9	204.5	16.1%	104.4%	83.9	11.0
1985	1648.2	1317.3	251.8	19.1%	138.7%	137.1	16.5
1986	1645.9	1138.8	277.2	21.5%	124.5%	151.2	24.0
1987	1696.1	1160.3	256.8	19.8%	105.8%	1.8	26.4
1988	1712.9	1414.8	260.5	18.4%	100.7%	168.4	17.2
CAGR 1983-88	.6%	4.4%	9.1%	3.7 pts.	9.7 pts.	7.8%	12.4%
CAGR 1985-88	1.3%	2.5%	1.2%	(0.7) pts.	(3.8) pts.	7.6%	1.4%
1989	1727.3	1582.2	336.2	21.3%	123.1%	185.6	24.3
1990	1802.8	1692.0	358.1	21.2%	118.4%	184.6	54.2
1991	1858.1	1824.3	389.8	21.4%	123.7%	220.7	27.4
1992	1873.7	1927.5	424.6	22.0%	128.0%	241.4	24.4
1993	1896.1	2040.7	470.8	23.1%	135.9%	271.0	22.5
CAGR 1988-93	2.1%	7.6%	12.6%	4.7 pts.	35.2 pts.	10.0%	5.5%

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Examining the GPG portfolio on a brand level basis highlights the need for GPG to focus turnaround efforts against three major businesses - Mayonnaise, Kraft Pourables, and Tablespreads. For both Mayonnaise and Kraft Pourables tonnage and share restoration is the key area of focus as both businesses, particularly Kraft Pourables, have demonstrated solid profit contribution potential. As stated earlier, turnaround programs are in place on both businesses and both volume and share are forecasted to improve in 1989. The challenge on Tablespreads is to improve profitability while maintaining tonnage and share. To that end, a major profit restoration program is in place with a planned operating income improvement of $23.7MM forecasted for 1989.

GROCERY PRODUCTS GROUP
BRAND LEVEL STRATEGIC PLAN HIGHLIGHTS

TONNAGE (MM LBS.) 1983	1988	1993	BRANDS/CATEGORIES	OPERATING INCOME (MM$) 1983	1988	1993
383	378	396	Miracle Whip	$83	$126	$185
177	150	159	Mayonnaise	19	23	40
21	24	26	New Viscous	7	5	9
169	158	183	Kraft Pourables	27	65	97
--	36	50	Seven Seas	--	5	8
132	159	161	Barbecue Sauce	7	18	34
420	397	400	Tablespreads	8	(10)	22
56	59	53	Fruit Spreads	1	0	1
60	70	77	Marshmallows	4	7	14
25	18	15	Confections	4	4	5
198	249	239	Traditional Dinners	24	81	98
--	--	31	Versatile Side Dishes	--	--	11
--	--	33	Shelf Stable Microwave Meals	--	--	6
--	--	59	Fat Replacement	--	--	5
25	15	14	All Other	0	(15)	2
1666	1713	1896	Total *	$168	$260	$471
--	.6%	2.1%	CAGR	--	9.1%	12.6%

* Total GPG Includes Food Service Penalty and Contingency Funds

The achievement of the Plan will insure that GPG will achieve its Mission of becoming the "Leading Dry Grocery Company". In fact, GPG will become the only company among the dry grocery peer group to achieve top quartile status in three key measures - operating margins, return on identifiable assets, and operating income growth.

The roadmap for achieving the Plan is based on a thorough Situation Analysis which led to the development of five key Strategic Thrusts necessary for the delivery of our objectives. For each Strategic Thrust we have identified 2-4 specific group strategies which must be diligently exercised to insure successful results.

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GROUP SITUATION ANALYSIS

There are eight key GPG learnings which provide essential insight into the GPG operating environment.

1. GPG tonnage is flat with limited opportunities for growth in existing categories. Situation: GPG categories have declined in tonnage (0.3%) CAGR for 1983-88. GPG brand tonnage has outperformed the categories, growing 0.4% CAGR 1983-88. There are select segments/categories which have demonstrated positive growth trends: Light/Reduced Calorie products have grown 33.2% CAGR 1983-88 and Traditional Dry Packaged Dinners have grown 4.7% CAGR 1983-88. Still, the overall next five year view for GPG categories is flat to slightly declining. Implications: GPG tonnage in core categories is not likely to dramatically improve. Growth opportunities continue to exist along the health dimension and in convenient dry packaged dinners. Importantly, core tonnage gains will have to come from share gains.

2. Historically, GPG operating income growth has been fueled by aggressive pricing while costs have only increased marginally. Situation: From 1983 to 1988 Net Sales increased $287MM (CAGR 4.9%) primarily as a result of pricing. At the same time, variable costs increased $74MM (CAGR 2.1%). The incremental margin generated by the pricing ($213MM) has been used to improve operating income, cover allocated costs, and to selectively support marketing and new product initiatives. Implications: In the face of declining categories with increased competitive activity and rising costs, it is unlikely that pricing will be as great a source of profit growth in the future as it has been in the past. Consequently, we must find additional sources of profit growth.

3. Productivity can drive significant profit increases. Situation: Productivity is becoming an increasingly significant contributor to GPG Operating Income - Productivity savings as a percent of GPG Operating Income were 9.9% ($24.4MM) in 1987, 12.4% ($34.6MM) in 1988, and are planned to be 15.3% ($57.4MM) in 1989. Implications: Productivity must continue to be a major focal point for GPG. Productivity can help drive operating income growth in an increasingly competitive environment where future gains from pricing will be more limited.

4. Existing strategic competitive advantages relate to individual brand franchises and are emerging for the total Kraft Business System. Situation: The primary source of competitive advantage for the GPG product portfolio lies in superior product, sales mass, and high relative market share. This is particularly true in Miracle Whip and Dinners. Pourables, Barbecue Sauce, and Margarine are beginning to develop/better leverage their competitive advantages as well. Additionally, the Kraft functional areas are demonstrating emerging strengths in the areas of Productivity (Operations), Fat Replacement (Technology), and Sales Leverage (Retail Sales). Implications: GPG must continue to maintain product superiority as a cornerstone for long term success. Additionally, GPG must fully support the functional competitive advantage initiatives. Consistent with this, GPG will work to further enhance the potential for functional advantage given our new association with General Foods.

5. The GPG competitive environment is intensifying, but in general we have been able to hold our market position. Situation: Since 1980 nine new major competitors have entered key GPG categories: Pourables - Campbells (1987), Clorox (1984); Barbecue Sauce - Hunts (1983), Heinz (1960/83), Clorox (1985), Campbells (1987); Dinners - Quaker (1986), Lipton (1980), CPC (1987). Also, in the face of soft categories, major market share battles

have erupted - particularly in the viscous category with CPC, in the margarine category with Unilever, and in the liquid pourable category with Clorox and Lipton. Despite the increased activity GPG market positions have generally been maintained. Implications: A number of well funded major competitors have entered our categories and are demonstrating a willingness to invest for growth. GPG must ferociously defend core franchises. Equally important, is the concept of ferocious offense - GPG must maintain a competitive franchise building consumer-directed profile in terms of copy and media spending.

6. Current spending mix trends are limiting our ability to leverage fixed spending strength against the consumer in our core businesses. Balance is beginning to be restored in 1988/89.
Situation: The GPG consumer versus trade spending mix slipped in 1987 to a higher trade spending profile, returning to the levels experienced in 1983. However, better balance is beginning to be restored. Also, the GPG media spending mix has drifted away from core business support toward new product spending, leaving the core franchises vulnerable to the increasing competitive activity. Implications: Consumer spending must be restored to the core franchises to insure competitive viability long term, particularly in direct advertising support. As well, unit trade spending must continue to be tightly controlled.

7. GPG new product initiatives have been substantial but have not delivered significant incremental volume. They have not fundamentally changed the GPG growth or product profile.
Situation: Over 300 new product concepts have been fielded since 1983 in GPG. Of these, 37 products have been placed in test. The top 10 new products since 1982 have added over 250MM lbs. of volume (14.9% of total GPG volume) but have contributed limited incremental volume (100MM lbs., 5.8% of total GPG volume). Importantly, all of the GPG successes have been close-in new products/line extensions. Implications: GPG must actively pursue two levels of new product activity. First, we must continue to develop and introduce targeted, high potential, close-in new products/line extensions as we have in the past. Second, we must uncover new sources of meaningful incremental volume that are well aligned with consumer trends. We believe that the Fat Free and Cholesterol Free extensions of our core franchises, as well as, the Versatile Side Dish and Shelf Stable Microwave Meal new ventures offer the significant incremental volume potential that is critical for GPG's long term vitality.

8. Individual GPG businesses are not equal in terms of growth potential and/or risk profile. Responsible portfolio management is essential to the long term success of GPG.
Situation: All GPG brands are not equal in terms of industry attractiveness or ability to compete. The Advantaged Franchises tend to have high relative market shares and good profitability in relatively attractive categories. Category attractiveness is determined by absolute size, growth, profitability, competitive intensity, and threat of substitutes. The Non-Advantaged Franchises tend to have lower relative market shares, lower profitability in relatively less attractive categories. Historically, despite repeated attempts, we have been unable to fundamentally change our portfolio profile. With the advent of increased profit targets, we cannot afford to do all things for all brands. Implications: We must manage GPG as a portfolio. The following chart delineates the guiding principles for the management of each portfolio of the portfolio.

GPG PORTFOLIO OBJECTIVES

PORTFOLIO SEGMENT	ADVANTAGED BUSINESSES	NON-ADVANTAGED BUSINESSES	NEW VENTURES
Focus	Balanced Growth	Returns	Aggressive Growth
CATEGORIES	• Miracle Whip • Mayonnaise • Pourables • Barbecue Sauce • Established Dinners	• Marshmallows • Confections • Jams, Jellies and Preserves • Tablespreads	• Versatile Side Dishes • Shelf Stable Microwave Meals • Fat Replacement
QUALITATIVE OBJECTIVES	• Achieve reasonable tonnage and acceptable O.I. growth	• Significantly improve O.I.	• Achieve significant volume growth with an acceptable ROI
GUIDING PRINCIPLES	• Superior products • Focused new product initiatives • Superior brand positionings and copy • Improved spending mix - Trade spending down - Consumer spending prudently metered • Ferocious defense • Aggressive but prudent pricing • Productivity	• Accelerate margin build program • Pursue lowest imaginable cost structure • Selective category restructuring initiatives • Continue to pursue product superiority with limited investment • New product activity limited to low risk line extensions	• Develop new business initiatives that clearly have leverageable competitive advantage • Initiatives must have potential to materially improve GPG sales and OI
QUANTITATIVE OBJECTIVES* (CAGR)	'85-'88 '88-'89 '88-'93	'85-'88 '88-'89 '88-'93	
TONNAGE	+1.4% +0.2% +1.0%	+1.6% (1.4%) +0.1%	
O.I.	+10.1% +13.0% +11.5%	(28.6%) +416.6% +153.3%	

In summary, these eight key learnings have provided important insight necessary for GPG to construct an aggressive strategic framework for successfully addressing and delivering the essential volume, share, and bottom line commitment.

GROUP STRATEGY

As indicated in the Plan Overview, we have identified five Key Strategic Thrusts for the Grocery Products Group with fifteen Group Strategies. Importantly, much of this activity is focused on helping GPG achieve its aggressive 1989 goals, as well as, establishing a strategic platform for long term growth. The following is a brief discussion of each of the five key Strategic Thrusts.

1. Accelerate Profit Growth

The need to insure accelerated profit growth is most dramatic in 1989, as the Operating Income target is \$336MM, +28.7% ahead of year ago. Over the five year planning horizon Operating Income is planned to grow 12.6% CAGR to \$471MM, +\$210MM versus 1988.

In order to achieve the planned profit goals we have adopted four fundamental group strategies. First, we will continue our aggressive but prudent pricing profile. We will continue to leverage our price leadership positions in Pourables, Barbecue Sauce, Macaroni and Cheese Dinners, Margarine, Confections and Marshmallows to continue to build gross margins. In the Viscous category, where we follow CPC with both Miracle Whip and Kraft Real Mayonnaise, we will continue to maintain a "Fast Follower" strategy. Importantly, we are pursuing for 1989 a major study to determine in Viscous how we can be the leader on price moves rather than depending on CPC. Miracle Whip accounts for 43% of GPG Operating Income and we simply must find a way to control our pricing profile.

The second group strategy, is to fully utilize productivity to build competitiveness. Our goal is to achieve $57MM in productivity savings in 1989. The projects are identified and an active implementation process is in place.

Our third strategy is focused on tight expense control. Specific programs have been put in place to more tightly control product cost, marketing spending, and overhead management. Finally, in order to better hedge our increased profit targets, GPG is implementing a strengthened forecasting and contingency planning process. The process includes an in-depth monthly review of each business from a tonnage, profit and contingency plan perspective.

2. Revitalize Core Franchises

As evidenced in the Situation Analysis, it is important that we fully recognize the inherent growth potential and/or risk profile of each of our individual businesses as we strive to effectively allocate resources and deliver profit targets. To that end, we have developed a portfolio model which provides relevant guiding principles and qualitative objectives for each group of businesses.

The Advantaged Businesses include Miracle Whip, Mayonnaise, Pourables, Barbecue Sauce, and Establsihed Dinners. This group of businesses is managed for reasonable tonnage growth and good returns. Each individual business has a very specific set of well defined operating strategies, however, we will highlight the strategic gameplan for only Miracle Whip (43% of 1989 GPG Operating Income), Kraft Mayonnaise and Pourables (targeted turnaround businesses in 1989).

The strategy for the continued successful management of Miracle Whip is five fold. First, a strategy for increasing the salad dressing buying rate via extended usage has been implemented. A major recipe dissemination program designed to encourage the use of salad dressing in recipes in lieu of other ingredients (particularly mayonnaise) is the primary thrust of this program. The second key strategy is to nationally expand the health focused advertising campaign "Change for the Better". This campaign is designed to persuade mayonnaise users to convert to salad dressing because it is lower in calories and saturated fat than mayonnaise. The third strategy for Miracle Whip is to introduce health-driven line extensions. As a result, no cholesterol Miracle Whip has been developed for market entry in the 1st quarter of 1989 and the Fat Free project is targeted for 4th quarter 1989 test market. The fourth strategy for Miracle Whip focuses on productivity. A number of major projects have been identified which promise to reduce costs in excess of $6.0MM annually. Finally, the fifth strategy is geared toward securing long term price leadership/independence from CPC. We are committed to finding a way to more independently manage our pricing destiny on this critical business.

Overall, the outlook for Miracle Whip is cautiously optimistic on the strength of the major health initiatives and the competitive copy platform.

The Kraft Mayonnaise business has been targeted as a major turnaround business for GPC in 1989 and beyond. We are committed to restoring volume growth and stabilizing our share position. In 1989 the category is anticipated to stabilize following a year of aggressive pricing (drought related) which created significant category softness (-6.0%). The 1989 turnaround program has four basic components. First, product based competitive advantages are being engineered into the product line. An improved Kraft Light Mayonnaise, which is at least parity with CPC Light, will be introduced in the 2nd quarter of 1989. Also, a no cholesterol Kraft Real Mayonnaise is scheduled for market entry in the 2nd quarter of 1989. Finally, the Fat Free project is targeted for test market in the 4th quarter of 1989.

The second strategy behind the Mayonnaise business is to renew competitive advertising support to strengthen the brand positioning in the marketplace. The spending principle will be to strengthen the brand share of voice to a parity level with CPC, the same approach successfully taken earlier in the 1980's. Third, the brand will employ a regional business management approach to account for diversity of market strength. Spending will be tailored by market to maximize impact and optimize returns. Fourth, the brand will aggressively pursue productivity to insure solid operating income performance while simultaneously investing for near term tonnage and share improvements.

The Mayonnaise program is complete and competitive. The key to success will be an effective near term tonnage and share turnaround in 1989 and the successful development and execution of health-driven line extensions in 1990 and beyond.

Overall, Kraft's total position in Pourables has been strengthened by the acquisition of Seven Seas in June 1987. The Seven Seas acquisition has given Kraft a legitimate market leading position in the most competitive sales region (the East) and has also strengthened Kraft's portfolio in the largest single flavor segment in the category (Italian dressing). However, as we have tried to effectively integrate Seven Seas into Kraft we have been hit by significant competitive activity from Clorox (Hidden Valley Ranch) and Unilever (Wishbone). As a result, the base Kraft Pourables share has been adversely affected. Importantly, we have built our Pourables business into a major profit contributor, with a 19.2% CAGR from 1983-1988 and this position needs to be aggressively defended for the future.

As in Mayonnaise, we are committed to turning around the tonnage and share position on the Kraft Pourables brand in 1989. We have four strategies designed to create this turnaround. First, product superiority is being stressed in all key segments. In the 1st quarter of 1989 the reduced calorie line is being relaunched with new improved products. Also in the 1st quarter of 1989 a major new item is being introduced into the market - Kraft House Italian. This product is significantly preferred versus the market leader - Wishbone Italian. Finally, a new improved regular Rancher's Choice is being introduced in the 1st quarter of 1989. This product also is significantly preferred versus the market leader - Hidden Valley Ranch. These two market entries (House Italian and Rancher's Choice) give Kraft preferred entries in the two largest flavor segments of the category, accounting for over 50% of category sales.

The second strategy on Kraft brand is to establish a leadership share of voice behind the preferred product entries based on a very competitive copy platform. The third strategy is to create innovative products for the long term. A fat free line will be developed and tested in the 3rd quarter of 1989. Also, the J.L. Kraft line of premium refrigerated dressings sold in the produce department will continue to be tested and optimized. Finally, a number of premium, health, and value concepts will be screened for further development. Fourth, and finally, as in Mayonnaise, we will aggressively pursue productivity as a means to maintain satisfactory operating income levels while we invest in the brand in the near term to turn around tonnage and stabilize our high share position.

Seven Seas is planned to be the growth brand for Pourables long term. We have successfully established a bold "flavor intensity" niche with Seven Seas that offers promise. We plan to fully leverage the flavor intensity positioning with competitive regional advertising. Also, we will nationally expand the Seven Seas Light brand in the 3rd quarter of 1989. Finally, Seven Seas will test market a new bold style Ranch dressing, also in the 3rd quarter of 1989.

Overall, the Pourables category promises to continue to provide meaningful operating income. The key challenge is to improve tonnage and stabilize the

Kraft Pourables share in 1989 and beyond. Seven Seas will provide additional growth through regional expansion and effective niche positioning.

The Non-Advantaged Businesses include Tablespreads, Marshmallows, Confections and Jams/Jellies/Preserves. This group of businesses is managed for a significant improvement in Operating Income while attempting to maintain tonnage and share. We will highlight the strategic gameplan for Tablespreads as it is the most significant non-advantaged business. Also, it is the third targeted business turnaround for GPC in 1989.

The challenge in the Tablespreads business is to restore profitability while maintaining tonnage and overall market position. The tablespreads category is the most competitive, trade-driven category in GPG. Additionally, the Kraft market position through the Parkay brand, is based in the least desirable, most competitive, and fastest declining segment - stick margarine.

In order to restore profitability both near term and long term, a four prong strategy has been developed. First, the focus is to improve returns on the stick margarine business while maintaining a share leadership position. This will be accomplished through aggressive but prudent pricing, superior trade deal management, and productivity. Second, we will build our position in the high growth/higher margin spread bowl segment. The key to our success in this area will be the successful management of our portfolio of brands. We will maintain an aggressive head-to-head posture versus Shedd's Country Crock with our Parkay Spread entry. We will expand our value-added spread, Kraft Touch-of-Butter, to capture a meaningful share of the segment at a higher profit margin. Finally, we will test a low price, value spread under the Chiffon brand name to capture further share of the spread segment.

The third element of our strategic platform is a commitment to aggressively strip out cost. We plan to strip out an incremental $10MM by 1990, with $5MM realized in 1989. The fourth strategy in Tablespreads has more of a long term perspective as we attempt to establish a meaningful high margin health positioned product to compete with Fleischmann's (Nabisco) and Promise (Lever). Two concepts are being pursued. The first is a Corn/Canola product that offers both superior health and a better buttery taste. The second, is a Fat Replacement project where we plan to offer the lowest fat product available with a taste comparable to Parkay Spread. Both projects will be marketed under the Parkay brand name and both will go into test market in late 1989.

As with Mayonnaise and Pourables, we are committed to turning around Tablespreads in 1989. In this case, the focus is on profitability as we aggressively implement the forementioned strategies in an attempt to generate a profit turnaround of $23.7MM in 1989. Overall, 1989 is a pivotal year for Kraft Tablespreads. We must turn the profitability profile around in 1989 and simultaneously position the brand for long term growth in both the spread segment and the higher margin health segment. The appropriate plans are in place. The key challenge is to insure flawless execution in 1989.

3. Create New Growth Initiatives
We have implemented a highly focused, strategically grounded new business program in GPG. The primary goal of the program is to develop significant incremental new businesses which are well aligned with consumer trends, which leverage Kraft strengths, and which offer the potential for meaningful competitive advantage. The first, nearest-in, growth initiative is Versatile Side Dishes. Versatile Side Dishes are an extension of the successful Kraft Macaroni and Cheese equity into other, primarily cheese based, side dishes - dry packaged potatoes, noodles, pasta salad, and rice. An 18 item line has been introduced into 5 of our 6 selling regions in the 1st Quarter of 1989 and initial results are promising.

The second initiative is Shelf Stable Microwave Meals. Our goal is to leverage our side dish expertise into the microwave meal category by entering test market with at least two new shelf stable microwave meal line entries in late 1989. We are currently pursuing 3 concepts: microwave single serve lunches, microwave add-meat meals, and microwave jarred sauces. All entries will utilize proven core flavors as anchors and will fully leverage Kraft heritage (through branding) and Kraft ingredient expertise (through flagging). We will also work closely with General Foods to better link our individual Shelf Stable Microwave Meal efforts.

Acquisitions are also viewed as a vehicle for meaningful growth. We have established an acquisition program which focuses on "deepening and extending" acquisitions. These would strengthen our participation in categories where we now compete or enable us to enter adjacent categories where our expertise is highly relevant. Additionally, we will be aggressive in pursuing opportunistic "broadening" acquisitions which would enable GPG to develop a potential new core business.

Finally, we have established a program for identifying New Growth Areas for GPG. Our goal is to identify at least 2 new growth areas (+$50MM) for GPG by Q1 1990. We have a four pronged approach. First, we consistently evaluate the feasibility of leveraging our brand equities into new categories (i.e. the Versatile Side Dish project). Second, we consistently look for high opportunity categories where we have the potential for competitive advantage (i.e. Shelf Stable Microwave Meals). Third, we are pursuing leading edge technologies which have relevant dry grocery application (i.e. Fat Replacement). Finally, we are identifying high potential packaging concepts which may lead to new growth opportunities (i.e. Microwave packaging).

4. Build Competitive Advantage

The primary thrust in the building of competitive advantage for GPG is in the area of Fat Replacement. Fat Replacement is critical to GPG because 66% of GPG volume and 75% of GPG Operating Income comes from high fat categories (Viscous, Pourables, and Margarine). Importantly, recent studies indicate that fat has become the top food ingredient concern for consumers. Finally, a number of ingredient companies and food manufacturers (including NutraSweet, P&G, Lever, CPC, Clorox) are actively developing fat replacement technology.

The objective of the GPG Fat Replacement effort is to maximize sales and profit potential by establishing a leadership profile in fat-free/low fat products in GPG categories. The key strategies include: 1) first to market, 2) with line extensions on existing brands, 3) which differentiate the Kraft technology by branding/marketing the fat free process, and 4) achieve product preference equal to or better than current light/reduced calorie flankers.

Overall, the Fat Replacement program is absolutely critical to the long term welfare and growth of GPG. We are determined to insure the success of this most critical project.

The second avenue for building competitive advantage is through Pan-Category Initiatives. Pan-Category initiatives are programs which cut across specific categories and are geared toward better harnessing the mass of Kraft. Fourteen specific projects have been established to improve GPG competitiveness. Some examples of Pan Category initiatives are an Oil Procurement Study (Project Slick) designed to improve our oil purchasing performance and a Superior In-Store Merchandising Program (Project Advantage) designed to find ways to better leverage GPG's dry grocery mass to obtain superior in-store merchandising.

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5. Develop a Superior Management System

This final major Strategic Thrust recognizes that the development of a superior management system is critical to the successful execution of the Plan. First, it is essential to have a high quality Training and Development program in place to insure constant skill building in all relevant skill areas. To that end, GPG, together with RPG, is developing and implementing a thorough Marketing Education (MEAD) program for implementation in 1989.

The second strategy for developing a superior management system relates to the concept of Functional Leadership. It is critical that GPG play a major role in driving functional goal congruence in order to effectively establish priorities, allocate resources, and to ensure profit targets are met. To that end, we have developed Strategy Statements for each function (Technology, Operations, Retail Sales, Consumer Promotion, Advertising Agencies, and Systems) which specifically articulate the GPG Agenda for that function. Through these Strategy Statements, we will drive goal congruence between the various functions.

The final group strategy is to continue to maintain Appropriate Control Mechanisms to insure that all programs are developed and executed in a high quality, timely, and on-budget fashion.

FINANCIAL IMPACT

The financial goals for the Grocery Products Group continue to be focused on achieving superiority (top quartile ranking) versus our relevant peer group companies in terms of 1) operating income margins, 2) ROIA, 3) sales growth, 4) operating income growth. To best understand GPG's consolidated financial performance we will separately review key base business plans and assumptions and new product growth initiatives.

Base Business

Our key strategic thrust for managing our base business is to revitalize core franchises. Our strategy for achieving this objective is to manage advantaged business for reasonable growth (+1.0%) and good returns (+11.5%), and manage non-advantaged businesses for aggressive returns (+153.3%) and modest growth (+0.1%). While revitalizing core franchises is essential to our long-term business health, the key profit driver continues to be gross profit margin improvement. With product costs going up faster in the next five years than in the last five (+3.8% vs. +1.0%), it is critical that we be more aggressive in pricing (+5.5% vs. +3.7%) and successfully achieve our aggressive productivity goal of saving over $82MM (4.0% of 1993 total costs) during the coming five years. As a way of further leveraging gross profit growth to the bottom-line, we will exercise tight control over non-strategic operating expenses (+5.1%), yet continue to support and invest against key strategic expenses (+10.6%). Key base business plan assumptions are highlighted below:

	1983	1988	1989	1993	'83-'88 % CAGR	'88-'93 % CAGR
Category Size	4,077	4,021	3,943	4,026	(0.3)%	--%
Market Share	31%	33%	33%	34%	2 pts.	1 pt.
Tonnage	1,666	1,702	1,696	1,763	0.4%	0.8%
Unit Selling Price	$.845	$1.013	$1.116	$1.324	3.7%	5.5%
Total product Cost	$.400	$.420	$.442	$.499	1.0%	3.8%
Productivity Savings	N/A	N/A	$10	$50	N/A	N/A
Gross Profit Margins	35.5%	42.9%	46.3%	48.0%	+7.4 pts.	+5.1 pts.
Operating Expenses:*						
Strategic Expenses	$178	$260	$288	$398	9.2%	10.6%
Other Expenses	141	206	214	398	9.2	5.1
Total Expenses**	$319	$466	$502	$657	9.2%	8.2%
Operating Income	$168	$279	$356	$448	10.75	9.9%

*Total GPG expenses

**Includes some costs classified as part of gross profit, e.g. plant overhead, consumer promotions, etc. of $81MM in 1983, $120MM in 1988, $121MM in 1989, and $149MM in 1993.

New Products

Our approach to managing new products is to aggressively pursue only highly focused and strategically grounded opportunities. Our key strategic thrusts are to create new growth initiatives and to build competitive advantage. Specifically, included in the plan are the 1989 introduction of Versatile Side Dishes, the mid-1990 national expansion of fat-free Miracle Whip, Mayonnaise, Pourables, and Table-spreads, and early 1991 introduction of Shelf Stable microwavable meals. The size and profitability of each of these new growth initiatives is highlighted below:

MILLIONS	VERSATILE SIDE DISHES	FAT REPLACEMENT*	SHELF-STABLE MICRO-MEALS
1993 Tonnage (lbs.)	31	59	33
1993 Operating Income	$11	$5	$6
Capital Requirements	--	$47	--
NPV	$4	$14	$2
IRR	28%	22%	21%
Payback	4 yrs.	10 yrs.	5 yrs.

*Incremental impact only

GROCERY PRODUCTS GROUP SUMMARY

As stated earlier, the GPG Strategic Plan is judged achievable. However, it will demand the best of our organization to realize the greater gains in the next five years than seen in the past five years. To this end, our strategies are clearly defined and the necessary executional plans are in place or being put in place. The challenge to GPG is to execute the Plan in quality, timely, and on-budget fashion.

TECHNOLOGY GROUP

The Technology Group mission is to achieve sustainable competitive advantage and growth for Kraft by 1) developing products and packages, based on proprietary and leading edge technologies, which consumers will recognize as superior to the best competitively available anywhere in the world, 2) ensuring that the on-going quality of our products and packages meets the highest standards, 3) costs optimizing our products and packages to deliver the best value to consumers and to the Company.

Technology has made considerable progress in the past few years in building the organization and programs needed to deliver superior packages and products. Overall, we now judge that our R&D capabilities have increased to the point of being on par to key competition. Kraft is the clear leader in some key areas (e.g. cheese and fats/oils technologies) but not others. Our competitive position in product acceptance has improved with recently implemented upgrades but there are still several important categories (such as mayonnaise, margarine, cream cheese and cheese slices) where improvement in consumer acceptance is still needed.

The Technology strategic plan calls for continued, orderly growth of R&D capabilities. We especially want to increase investment against pacing and breakthrough technologies, such as microwave, cholesterol removal and aseptic processing/packaging. Resources have been restricted in areas of upstream research and development during the past few years because of an intentional short term focus on KPP. We plan to begin to restore more of a balance starting this year.

Also, Technology and Quality and Assurance have made considerable progress in recent years in improving the corporate focus on quality. The Quality Assurance organization is making good progress against building an infrastructure to meet quality goals. Although we still need to improve systems for approving, implementing and monitoring changes, we have made important improvements recently with issuance of the Corporate Quality Manual and the Research and Decision Guidelines for KPP changes to assure product quality is not compromised.

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We have also made dramatic progress in improving the value of Kraft's products. This is being achieved by delivery of KPP savings available from streamlining current products packages, processes and operations, and by building in more value when new products are initially designed. We are also continuing the internal program to save 2.3% of the R&D budget each year by ongoing productivity upgrades in how we do research.

Strategically our focus remains on technologies and products which will lower cholesterol and reduce fats and oils (especially saturated fatty acids) in our brands. Our basic focus in packaging is on convenience packaging and KPP optimization, and in process development on new and improved processes which enable delivery of new products and of optimization plant processes.

Overall, 1989 will be a year of further emphasis on delivery of committed projects, while continuing programs which are crucial to meet the Technology mission.

SUMMARY OF KEY PROGRAMS

The priority business building programs supported by Technology are as follows:

- Continued top priority on fat substitutes (primarily Trailblazer) to address the largest vulnerability in our business issues related to fat and cholesterol. Fat free products being developed based on these technologies include ice cream, pourables, viscous, cream cheese and slices.
- Product and Packaging upgrades, particularly for core businesses, e.g. cholesterol free Miracle Whip and Mayonnaise and reclosable packaging for natural cheese.
- Delivery of $15.3MM in KPP savings to the company bottom line in 1989 (including $1.6MM in internal R&D savings).
- New products such as the Chilled Foods line and Shelf Stable Microwave products.
- Upstream technologies to provide the basis for future upgrades, e.g. cholesterol removed from eggs and interesterification.
- Further evolution of the Corporate Quality Program, e.g. implementation of the product and specification change system.

ORGANIZATION BUILDING PROGRAMS

Beyond direct business building efforts, we are continuing the organization building programs which are critical to the future.

- Continuing the upgrading of the R&D organization.
- Further developing the execution of a consumer-driven product development process, based on in-depth consumer understanding.
- Further improving linkages with key Marketing and Operations partners.
- Defining ways to access outside research important to Kraft.
- Exploiting the opportunities achieved via the synergies and strengths of the combined KGF R&D organization.
- Expanding lab space and pilot plant capabilities to keep pace with organizational growth and leading edge technologies.
- Further implementing and refining the quality systems.
- Establishing systems to better anticipate, maintain and respond to competitive developments.

RESOURCE IMPLICATIONS

The Technology strategic plan calls for continued manageable growth of Technology over the next 5 years, as illustrated below. The largest single component of the 1989 budget is the Trailblazer (Fat Replacement) program ($11.1MM).

PROJECTED EXPENSES (MM$)

	88	89P	90P	91P	92P	93P	88-93
Bus. Group Proj.	37.6	44.2	48.3	52.7	56.8	61.7	10.4%
HQ Projects	19.9	17.4	18.6	20.6	22.4	24.1	4.1%
Total R&D	57.5	61.6	66.9	73.3	79.2	85.8	8.3%
QA	3.5	3.5	3.8	4.0	4.1	4.1	3.2%
Grand Total R&D/QA	61.0	65.1	70.7	71.3	83.3	89.9	8.1%

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Following a decrease in headcount from 694 to 658 in the 1989 post acquisition year, plans call for growth of R&D/QA headcount from 658 to 763 over the next four years -- almost all in R&D.

The capital spending proposed over the next 5 years is (MM$):

88	89P	90P	91P	92P	93P	TOTAL
12.4	18.7	24.2	22.7	10.1	8.0	96.1

1989 capital is dominated by Trailblazer ($5.6MM). The increased spending in 1990 and 1991 is necessary to 1) expand pilot plant capabilities ($20MM total), 2) maintain our computer network ($4.0MM), and 3) build a sorely needed second building expansion ($11.9MM).

SUMMARY OF KEY PROJECTS AND DELIVERABLES

RPG - On grated Parmesan, we will incorporate tamper evidency (3Q '89) and increase moisture to save $4MM annualized (3Q '89). On Velveeta, we will develop a new convenient, reclosable package (4Q '89). For cream cheese, the focus is a no fat soft Philly (4Q '89), and a new process which will save $1.2M in 1989. Reclosable packages superior to competition is the focus in natural cheeses (3Q '89). The sandwich category is concentrating on healthier cheeses with a fat free slice (1Q '90), a quality analog cheese (2Q '90), and Project Right Stuff (1Q '90). Chilled Foods will expand from test market (3Q '89). In 1989 R&D will deliver RPG KPP projects with an annualized value of $14.2MM.

GPG - On tablespreads we are working to improve Parkay Spread (1Q '89) and Parkay Squeeze (3Q '89) and to develop a new low fat product (3Q '89). Following the Versatile Side Dish introduction (1Q '89), we will add VSD line extensions (1Q '90) and, separately, introduce new macaroni add meat dinners into test market (3Q '89). On viscous, our focus is cholesterol free products (2Q '89), fat free products (1Q '90), and a major productivity and quality improvement with Pentax (3Q '89 first application). Pourables top priority is to introduce a line of fat free products (3Q '89). In 1989 R&D will deliver GPG KPP projects with an annualized value of $29.9MM.

VENTURE (NEW PRODUCTS) - We are pursuing several new product initiations including a shelf stable hot lunch line (1Q '90 TM) and a new microwave opportunity to be identified by 4Q '89.

UPSTREAM TECHNOLOGIES (HQ PROJECTS) - In addition to the above product efforts, our Basic Sciences and Technology Development functions are pursuing the projects needed to assure a flow of future product upgrades. Specific efforts are focused against cholesterol removal, aseptic processing/packaging, microwave technologies, further fat substitute technology, healthier fats/oils technologies (e.g. interesterification), processes of the futures (e.g. casein fractionation), moisture management, and the psychology and physiology of foods.

OTHER DIVISIONS - Beyond these efforts Technology has programs in place to support Canada, the Frozen Foods Group and the Commercial Group.

OPERATIONS GROUP

Strategic direction for 1989 and beyond for the Operations group can be summarized in three key elements. First, the overall mission and strategic direction for Operations. Second, Operations' strategic focus on cost improvement. Last, strengthening organizational capabilities to execute this strategy.

OPERATIONS MISSION

The Operations group can contribute to achieving the overriding mission of the "Leading Food Company in the World". While the business units have clear, ongoing, and contributing roles to the mission, the Operations' role and responsibility is one of functional support. Consequently, Operations will strive to provide competitively advantaged products and services to operating units and other customers. These products will be developed, produced, and delivered such that no competitive supplier can provide lower cost products at desired quality and service levels.

STRATEGIC FOCUS ON COST

With over $800MM in management investment in Operations, and nearly $2.8 billion in budgeted costs, it is clear that effectively managing assets and efficiently managing costs are fundamental to the Operations' strategy for today and the future.

In 1988, the Operations Group made the Kraft Productivity Program a central commitment strategically, financially, and organizationally. As a guiding strategy for future, Operations will manufacture and distribute the core food products for Kraft operating units, driving towards the "lowest imaginable cost" without compromising or sacrificing the quality or service required to sustain business growth and success.

From this strategy, three fundamental "strategic drivers" have emerged. First, optimizing the production structure creates opportunity for capacity and cost efficiencies. Second, refining production methods and processes increases the overall efficiency and corresponding costs of production. Finally, meeting customer requirements with adjusted product and packaging specifications creates opportunities to reduce cost and frequently to improve product performance.

The cumulative savings from the three strategic drivers is projected to reach $210MM over the next five years. We are managing this multi-year effort through projected long-term cost curves which record prospective changes across all three of the driving strategies. By concentrating on the company's core products, we ensure that improvements have the greatest reward by leveraging the majority of the group's tonnage.

ORGANIZATIONAL SKILL BUILDING

Finally, and possibly most importantly, the organizational change and skill upgrading required to see this strategic direction and mission accomplished are paramount. Much progress had been made in this area structurally, culturally, systematically, and with new people. The effort to mobilize the organization and focus on sustained improvements will continue.

At Headquarters, strategic project evaluation and the KPP process have driven the increased focus on quantitative analysis, modeling, and statistically based decision-making. In the plants, Statistics Based Management (our version of SPC) has been initiated, increasing attention to analysis and organization accountability.

Product focus is insured through Business Unit Managers and Operations Supervisors who have product based responsibilities. This has been supplemented through a broader role for our headquarters based Operations Business Manager whose efforts are directed at managing change through our production system, achieving short-term goals for our products, managing quality and also managing the long-term cost curve.

Taken together, skill building and our newly sharpened organization should facilitate our programs in 1989 and beyond.

RETAIL SALES GROUP

BACKGROUND

The Kraft Sales organization is comprised of 6 regions and 58 districts with a 2,000 person line selling organization; and a 330 person accounting staff deployed in five regional Accounting Centers. Over 1,000 Kraft Sales Representatives sell Kraft Refrigerated and Grocery products, and broker refrigerated dough (Pillsbury) and citrus products (Erly Industries) in 30,000 stores nationwide. Additionally, the organization has approximately 475 Account Managers, 65% of which are split between Refrigerated and Grocery.

In 1988, the selling organization sold over $4.5 billion in Kraft, Pillsbury and Citrus products across 22 categories. In addition, the organization handles over 1,600 SKU's, with an average account having approximately 300 authorizations.

VISION/MISSION/OBJECTIVE

Our Vision is to be the standard of quality in the Industry. To accomplish this, our Mission is to gain competitive advantage for Kraft's products and programs in retail stores by 1) leveraging the significant Kraft resources; 2) developing our people to realize their full potential; and 3) focusing the organization against key measurable activities. If we are successful in these activities, we will achieve our objective of realizing sustained profitable tonnage growth, while at the same time improve the cost effectiveness of the sales organization.

STRATEGY

Our strategy is to focus on getting more of "what works" to build our business, i.e., authorizations, distribution, shelving, displays, profitable tonnage, productivity and organizational skill growth. We call this ADSD/PT/P/GO! ADSD gives us clear focus against key controllable sales measures. Profitable tonnage (PT) provides the right direction for product and program efforts in ADSD. Productivity (P) means increased selling effectiveness, measured by lower selling costs per dollar of sales. At the same time we grow the business, we will continually grow ourselves (GO!) by upgrading our organization through recruiting, training and career development.

TACTICS AND ACTION PLANS

There are two ways we will implement our strategy. The first is to "ask for it" by setting clear objectives, by providing organization accountability and ownership, and by measuring performance against these objectives and standards.

We have set and will track key ADSD/PT/P/GO objectives as follows: authorizations - 100% top 400 items; distribution - 100% chains, +10% independents; shelving-space equals share with strategic positioning; displays - +10%, profitable tonnage - +1% versus plan; productivity - expense reduction as a percent of dollar sales and increased selling effectiveness; grow ourselves - skill development.

The second way to implement our strategy is "to enable it" in the following ways:

1. Skill Development - We will upgrade to effectiveness of our organization by implementing Profit Based Selling techniques, by coordinating all trade incentive funds in a single, more flexible budget (Project T.E.A.M.), and by providing negotiation skills and teamwork/leadership training. In addition, a new personnel planning and review system was initiated to improve personnel placement and career development. Job roles in the field will be focused and clarified in 1989. Finally, we will institute a profit based bonus system which will result in better prioritization by the field in order to generate profitable tonnage.

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2. Trade/Marketing System Enhancements - A promotion bundling program has been designed and is being implemented to increase trade impact and simplify the deal process. A new unified pricing program has been implemented and the corporate sale program will be expanded in 1989. To add more flexibility, a promotion performance menu will be offered whereby accounts can select promotion options which best meet their individual strategies. Finally, we will continue to work with Marketing on improving our promotional programs and trade incentive strategies/plans, and will continue to identify and test new alternatives.

3. Information System Enhancements - Our long-term strategy in information systems includes development and utilization of one communication and data system. In the field, lap-top computers for analysis and communication utilization by Account Managers will be tested and expanded if successful. Finally, we are developing a priority micromarketing system, and Refrigerated and Grocery category expert systems.

4. Service/Support Systems Enhancements - A new order entry system project designed to improve order placement, shipping and billing will be completed over the next several years. In addition, we will continue to work on developing leading edge industry policies with near term focus on terms, slotting allowances, unsaleables, customer service and promotion performance.

5. Focus Resources/Structure - We will be reorganizing our Field Organization in 1989 and 1990, commencing with a structure test in the Central Region. Selling functions through the Region Manager level will be split into account headquarters selling and retail operations, which will result in improved customer focus, penetration and vertical execution. In addition, a customer service function is being established to strategically and operationally align with our customers' distribution and systems functions.

KRAFT U.S.A. SUMMARY

As stated in the Kraft U.S.A. Plan Overview, overall, the Kraft U.S.A. Strategic Plan is ambitious but achievable. There are four fundamental keys to success. First, we need to make the planned quantum leap in profitability in 1989 without jeopardizing our short term or long term market positions. Second, we need to continue to build and defend our core grocery and cheese businesses by continuing to build competitive advantages and by adding-value. Third, we need to successfully execute our key new business initiatives, especially Fat Replacement, Chilled Foods, and Versatile Side Dishes. Fourth, we must successfully execute our key functional initiatives, particularly the Operations Group Productivity Program and the Retail Sales leveraging programs. We have the plans in place to succeed on all four dimensions, the challenge before us is to continue to refine our strategic thinking and to flawlessly execute the resultant plans.

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INCOME STATEMENT

	1988	1989P	1990	1991	1992	1993
Volume	2,940	2,858	2,975	3,088	3,159	3,279
Net sales	$4,114	$4,396	$4,643	$4,962	$5,264	$5,720
Operating revenues	4,114	4,396	4,643	4,962	5,264	5,720
Var Cost of Product sold	2,133	2,171	2,245	2,346	2,439	2,610
Shipping expense	160	162	181	201	217	244
LIFO adjustment	0	0	0	0	0	0
Cost of sales	2,293	2,333	2,425	2,547	2,656	2,854
Marginal Contribution	1,821	2,063	2,218	2,415	2,608	2,865
Fixed manufacturing costs	125	127	130	135	138	146
Available profit	1,696	1,936	2,088	2,280	2,470	2,719
Marketing	997	993	1,101	1,219	1,279	1,371
General and Admin.	98	103	108	114	121	129
R & D	47	46	44	45	49	51
Curr. Trans./hedging costs	0	0	0	0	0	0
Other (inc)/exp	(3)	1	(2)	(1)	0	0
Total expense	1,138	1,143	1,251	1,377	1,449	1,552
Income from OPs., before Int., Goodwill & Assessments	558	793	837	903	1,021	1,167

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KRAFT GENERAL FOODS
GROUP: KRAFT USA
MANAGEMENT INVESTMENT

($ MM)

	1988	1989P	1990	1991	1992	1993
NET RECEIVABLES	151	217	228	247	267	299
NET INVENTORIES	518	481	493	501	517	543
PREPAID EXPENSES	5	5	5	6	6	7
NOTES PAYABLES	0	0	0	0	0	0
A/P & ACCRUED LIABILITIES	322	293	303	316	331	349
WORKING CAPITAL	352	410	423	438	459	500
NET PROP, PLANT & EQUIP	519	605	644	729	799	905
INV & ADV TO UNCONS SUBS	0	0	0	0	0	0
TOTAL Y/E MANAGEMENT INVESTMENT	871	1,015	1,067	1,167	1,258	1,405

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GROUP: KRAFT USA
CASH FLOW STATEMENT

($millions)

Source/(Use) of Funds	1988	1989	1990	1991	1992	1993
Income From Operations	$558	$794	$838	$903	$1,021	$1,167
Income Taxes	212	302	318	343	388	443
Net Income	346	492	519	560	633	724
Add: Net Corporate Assessments	0	0	0	0	0	0
Net Income Before Corporate Assessments	346	492	519	560	633	724
Amortization	0	0	0	0	0	0
Depreciation	37	36	39	43	47	52
Deferred Taxes	0	0	0	0	0	0
Change in Accounts Receivable	21	(66)	(11)	(19)	(20)	(32)
Change in Inventory	34	37	(12)	(8)	(16)	(26)
Change in A/P & Accrued Liabilities	55	(29)	10	13	15	18
Change in Income Taxes Payable	0	0	0	0	0	0
Other, net	(1)	0	1	(1)	0	(1)
Funds from Operations	491	470	547	588	659	735
Capital Expenditures	(75)	(102)	(119)	(132)	(115)	(151)
Other Invest & Acquis, net of Divest	(13)	(28)	40	5	(2)	(8)
Free Cash Flow	404	340	468	460	542	576
Long Term Debt Retired	0	0	0	0	0	0
Net Interest Expense(After Tax)						
Corporate Assessment(After Tax)						
Reduction of Untendered Kraft Stock						
Financing Provided	0	0	0	0	0	0
Change in Intercompany Account	$404	$340	$468	$460	$542	$576

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KRAFT GENERAL FOODS INTERNATIONAL

Kraft General Foods International

NOTE

Discussion and analysis of competitors is based on public information and internal modeling of competition developed by the Planning Department. Projections and discussions of future actions by competitors are primarily based on extension of historical trends within the context of Kraft General Foods International's forecasted food industry environment.

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KRAFT GENERAL FOODS INTERNATIONAL

A. OVERVIEW

1. THE TOTAL BUSINESS

1) BACKGROUND

The combined Kraft and General Foods international businesses create one of the largest food businesses outside of North America with 1988 reported revenues of $4 billion (or $5 billion on a 100% basis).

The company has a strong operating presence in most of the key international markets and is well positioned geographically to benefit from two significant external forces...the regionalization of Europe ('1992') and the growth of the Asia/Pacific region.

	1988		
	Operating Revenue		
	Reported	100%	Income
Europe	$3137	$3223	$241
Asia/Pacific	333	1227	53
Latin America/ World Trade	452	651	65
HQ/Other	-		(43)
Total	$3922	$5101	$316
Memo: Per KGF Fact Book Forex	$4046	$5225	$336

Our product portfolio is most highly developed internationally around two 'core' businesses.....coffee and cheese. These core products provide operating scale on which to further build our grocery portfolio as well as many opportunities to extend these core products to new countries.

	1988 Revenue	
Key Products		
Coffee	$1109	28%
Cheese	812	21
Other Products	2001	51
Total	$3922	100%
Memo: Per KGF Fact Book Forex	$4046	

The KGFI company also benefits from multiple distribution systems to access a wide range of outlets and eating occasions. GF's strength is predominately in dry grocery systems while Kraft brings a strong refrigerated system in many countries, plus both companies are developing systems beyond retail in the food service and vending segments.

Note: All financials are stated at C'89 Forex Rates.

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Competitively, KGFI will be competing against both the leading food multinationals (Nestle, Unilever, CPC) as well as strong regional/local companies. We are well positioned to achieve superior results competitively given the breadth of our portfolio, the strength of our franchises, our distribution systems, and the quality and depth of management brought together by this merger.

2) FINANCIAL OUTLOOK

The management of the new KGFI company has not had the opportunity to develop an integrated strategic or financial plan. What follows is an addition of the five year plans for the international businesses of Kraft and General Foods.

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	3.9%	$1,913	$2,986	9.3%	$167	$335	14.9%
General Foods	5.4	2,009	2,915	7.7	149	238	9.9
KGF International		$3,922	$5,901	8.5%	$316	$573	12.7%
Memo: Per KGF Fact Book Forex		$4,046	$5,901	7.8%	$336	$573	11.3%

This forecasts volume growth in the range of 4-5% annually with combined income growth of 13% annually. With the potential synergies available in reducing costs in general overheads, selling and distribution systems, we should be able achieve the aggressive near term earnings forecast. Five year goals are dependent on a mix of acquisition opportunities and new product expansions, as well as growth in core franchises.

Our near term synergy focus will be to reduce the headquarters costs at both the international and regional levels which should produce significant earnings benefits in 1989. We will also begin to integrate country operations which will have a further positive impact on earnings in 1990.

The following sections provide a brief financial perspective of the combined KGFI operations by region and for key countries and highlight the current strategic plans for each business. We also indicate where the highest potential synergy areas appear to be at this time.

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2. THE KRAFT BUSINESS

BACKGROUND

Kraft has sales of $1.9B outside of North America, spread over 100 countries. However, 75% of volume is in our top four countries--Italy, Germany, Australia, and the U.K.

The product mix is spread among cheese and a line of grocery products that largely mirrors the U.S. business.

	Cheese						Viscous		Other		
	Philly	Mama Luise	Cheez Whiz	Singles	Cracker Barrel	Velveeta	Miracle Whip	KRM	Mira-Coli	Mato Mato	Kraft Pour-ables
U.K.	•			•	•						•
Ireland	•										
Australia	•			•	•		•	•			•
Hong Kong	•			•			•				
Germany	•			•		•	•	•	•	•	•
Italy	•	•		•				•		•	
Spain	•	•		•				•		•	
Belgium	•			•				•	•		
Denmark	•						•		•		•
Japan	•										
Mexico	•		•	•			•	•			
Venezuela	•		•	•		•		•			
Panama				•			•	•			
Philippines			•	•			•	•			

Competition is both multinational and local. Multinationals are increasing their country mass and increasingly attempting to 'own' categories worldwide, for example CPC (mayonnaise), Unilever (margarine), Heinz (ketchup).

Our key competitive advantage is the strength of our franchises which have predominately number one or number two shares in their categories. This results in superior returns and leverageable pricing advantages. A further competitive advantage is our ability to transfer products, innovations, and marketing programs across countries.

The last three years have seen International's profitability reach record levels. Operating income, only $89MM in 1983 and falling, grew to $167 million in 1988, an increase of 88%. In 1987, KI was tops among its peer group in ROA and among the leaders in ROS. By far the bulk of this improvement (85%) was internally generated, mostly as a result of improved margins.

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This successful turnaround was driven by three basic strategies. Firstly, we focused on ensuring core countries were strategically sound and well managed. Secondly, we focused on core categories where we have concrete advantages vs. competition. This required that we deliberately surrender 57,000 MT of unprofitable non-core tonnage. This amount would represent 7.4% of 1988 shipments. This concentration on renewing and extending these cores reversed a strategy of actively investing in new brand equities. Finally, we attacked costs and expenses throughout. By the end of 1988, we are producing 19.4% more tonnage than in 1984, but using 252 fewer people. Five plants have been closed, and others streamlined and restructured.

KEY STRATEGIES

We are continuing the strategies we have pursued with success over the past three years in the belief that there remains significant opportunities to leverage our core businesses and improve margins.

- pursue selective growth
- develop world class management
- defend core businesses ferociously
- maximize core business potential
- pursue "lowest cost imaginable"
- actively search for acquisitions that fit our cores

The 'selective growth' strategy requires increased emphasis. This will necessitate an increased role for acquisitions. Our internal development process has not delivered sufficient volume to keep pace with competition.

FINANCIAL OUTLOOK

	Avg. Annual Growth C'83-C'88	Avg. Annual Growth C'88-C'93
Tonnage	2.5%	3.9%
Operating Revenue	8.5	9.3
Operating Income	13.3	14.9

An aggressive income objective has been committed to which will depend on expanding and holding margins. This requires changing the financial structure of the business by aggressive pricing early in the plan, then spending back part of the increased income to fuel tonnage growth.

All regions will contribute to this with Europe producing the bulk of the increase, but Australia and Latin America also have challenging goals given their operating environments.

	1988 IFO	1988 ROS	1993 IFO	1993 ROS
Europe	$115.0MM	8.9%	$223.3MM	11.0%
Asia/Pacific	42.0MM	15.2%	85.4MM	20.0%
Latin America/Export	16.0MM	9.8%	35.3MM	11.9%

Capital investment will grow to $103 million per year in 1993, well above 1988 expenditures of $50. This meets the increased need for investment to support the productivity push.

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Risks to the Plan

1. COMPETITION

The major risk to the plan is from increasing competition in our core businesses, particularly at a time when we are attempting to increase margins and reduce spending, plus integrate with General Foods. This will require aggressive defense against any attempted competitive inroads, plus exemplary execution of our programs.

A further risk is that competitors who have identified the same growth dynamics in consumer trends (convenience, freshness, lightness, microwaves) will be competing for the same menu segment opportunities....both in new products, and pursuit of acquisitions in these areas.

2. TRADE BARRIERS

As trade barriers are reduced in Europe ('1992'), and in Asia (Australia/New Zealand CER), our established operations will be threatened by new competitive entries. For example, we expect the New Zealand Dairy Board currently constrained in entering Australia, to attempt to gain share from our Australian business through aggressive pricing tactics.

This underscores the need to be cost competitive and to clearly signal we will aggressively defend our businesses.

3. COMMODITY PRICES

Prices of our two major commodities, oil and dairy products, present both risks and opportunities.

Dairy prices have risen sharply, in contrast to long term declining trends as stock piles have been depleted. Oil prices have also risen but are now showing stability.

Commodity price increases provide opportunities for price increases, particularly where we have strong trade resistance to pricing (Germany, Belgium). However, in several countries (Mexico, Venezuela) government regulations limit our ability to totally recover costs, and present added risk to price volatility.

We are hopeful that commodity prices will plateau relatively soon, but we are unlikely to see a return to the low points of recent years.

3. THE GENERAL FOODS INTERNATIONAL BUSINESS

BACKGROUND

GF's international business is centered in two core businesses... coffee and powdered beverages, which account for 61% of revenues. In addition, in several countries we have strong well insulated local businesses such as Hollywood gum and Krema candy in France, Kibon ice cream in Brazil, and Simmenthal canned meat and tuna in Italy.

The coffee and powdered beverage businesses span most international countries. The most common coffee trademark is Maxwell House, plus we have several acquired franchises such as Gevalia coffee in Sweden, Saimaza coffee in Spain, and Kenco coffee in the U.K. The powdered beverage portfolio is dominated by the Tang and Kool-Aid trademarks which we have transferred across Latin America and selected markets in Asia and Europe.

	Coffee	Powdered Beverages	Desserts	Gum/ Candy	Ice Cream	Canned Meats
U.K.	•		•			
Germany	•	•				
France	•	•		•		
Switzerland	•	•		•		
Sweden	•					
Denmark	•			•		
Belgium				•		
Spain	•	•		•		
Italy	•					•
Brazil		•		•	•	
Mexico	•	•	•			
Japan	•					
Korea	•					
China	•	•				
Philippines		•				

Competitively, we are the market leader in R&G coffee in Sweden, Denmark, U.K. Our soluble coffee franchises generally have a strong #2 market share with Nestle being the market leader in most countries, resulting from their pioneering role in developing the instant coffee business worldwide. Korea is an exception to this, where GF has a strong leadership position in soluble coffee. Even where Nestle has the number one position, attractive returns can normally be achieved given the Nestle margin strategy and aggressive management of costs by GF.

The powdered beverage business enjoys franchise leadership in all countries given GF's pioneering of this category across the world. Competition is diverse, usually local and generally competes on price.

KEY STRATEGIES

The strategies we have been following over the past several years remain in place as they have proven effective.

- selectively grow the coffee business in both retail and food service
- extend the powdered beverages into new countries and new consumer segments
- protect and develop local businesses
- aggressively reduce costs
- capitalize on cross country, regional leverages
- pursue selective acquisitions that strengthen core businesses

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This has resulted in performance at or above plan with international volumes growing by 4.0% and income by 29.0% over the past five years.

	Volume Growth	Income		
	C'83-C'88	C'83	C'88	Avg Annual Growth
GF International	4.0%	$42	$149	29.0%

The priority of strengthening our coffee business has also seen good progress with volumes growing 6.0% over the past five years. Product quality has been improved to achieve superiority or parity to competition in most countries, new products have been successfully introduced, acquisitions have been made in the U.K. and Denmark, retail market shares are up, and the business has been broadened into food service. The main coffee issue we are facing today is the need for greater competitive scale in Europe, notably in France, Germany, and Spain.

The continuation of this strategy calls for heightened new product activity in extending key coffee trademarks into new segments (Maxwell House decaf in the U.K., Maxwell flavored coffees in France, Saimaza soluble coffee in Spain), development of liquid microwavable coffees, and expansion of the Maxpax vending system across Europe and into Asia.

The powdered beverage business has been broadened internationally with expansion of the Tang and Kool-Aid franchises; however, growth expectations have not been achieved (volume -1.3%, income -.3% C'84-88) given the economic dislocations in Latin America.

The local businesses have further strengthened their leadership positions. The confectionery business in France has grown share as Krema has achieved #1 position in the pocket candy segment and the product line has been further strengthened through the acquisition of Stimorol gum. The Kibon ice cream business has grown its leadership position through new products. Simmenthal sliced beef business in Italy has been successfully extended into canned meat and tuna salads.

FINANCIAL OUTLOOK

The five year plan projects volume growth of 5.4% and income growth of 9.9% per year. Geographically, the growth is driven by strong volume growth in Europe and Asia/Pacific.

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
Europe	4.4%	$1684	$2484	8.1%	$125	$209	10.7%
World Trade/ Latin America	3.7	289	365	4.8	49	61	4.5
Asia/Pacific	10.1	36	64	12.0	11	23	16.2
Coffee Dev.	-	-	-	-	-	(16)	-
HQ	-	-	2	-	(36)	(39)	-
Total	5.4%	$2009	$2915	7.7%	$149	$238	9.9%
Memo: Per KGF Fact Book Forex		$2092	$2915	6.9%	$161	$238	8.1%

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Volume growth will be driven predominately by the coffee business, growing at +5.8% annually, while income growth is led by local country businesses which have greater margin leverage.

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
Coffee	5.8%	$1109	$1707	9.0%	$94	$125	6.0%
Cold Beverages	5.1	110	142	5.2	19	26	6.4
National Franchises	4.3	492	731	8.3	61	100	10.6
Other Businesses	4.9	299	334	2.2	11	25	16.8
HQ	-	-	-	-	(36)	(39)	-
Total	5.4%	$2009	$2915	7.7%	$149	$238	9.9%
Memo: Per KGF Fact Book Forex		$2092	$2915	6.9%	$161	$238	8.1%

Capital investment will be maintained at the current level through the strategic plan period. (C'93 expenditures: $88MM vs. $91MM in C'88), as we control spending within competitive and affordable levels.

Risks to the Plan

1. COMMODITY COSTS/PRICING

Green coffee prices have been very volatile and there is great uncertainty as to whether the International Coffee Agreement will be renewed in 1989. As green costs have escalated in Europe in 1989, we have had great difficulty in increasing prices as both competition and the trade have resisted price increases. Our plan assumption is that green coffee prices will fall later in 1989 as the ICA agreement collapses and that target margins will be achieved. The uncertainty around this assumption is a major risk in our coffee earnings forecast.

2. COMPETITION

We are assuming continued vigorous competition in the recommended plans and financial forecasts including successfully defending against Nestle's entry into Korea. Not assumed in the plan is any significant restructuring or new entries into the business, such as Jacobs, a major European roaster, expanding into Asia, which could endanger our profitable #2 positions behind Nestle.

EUROPE

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
Kraft	4.2%	$1,453	$2,224	8.9%	$115	$223	14.1%
General Foods	4.4	1,684	2,484	8.1	125	209	10.7
KGF International		$3,137	$4,708	8.5%	$240	$432	12.4%

Note: In constant '89 forex

The five year financial outlook of the combined companies is to grow volumes 4% annually with income growing at 12%. We judge that we should achieve this strong projected income growth as we capture the cost saving advantages of the combined businesses and create new growth opportunities in both new products and acquisitions.

Revenues of over $3 billion position KGF among the leading food companies in Europe, ranking #5, following Nestle ($10.2), Unilever ($8.8), BSN ($6.2), and Jacobs Suchard ($3.4).

KGFI's major European businesses are in Germany, Italy, and the U.K., with these three countries accounting for 68% of European revenue and 80% of income. Positions in France, Spain, and the Scandinavian countries, are far less developed and should offer opportunities for growth.

The businesses of Kraft and GF are very different yet offer significant opportunity for cost savings through synergy and exciting opportunities for developing a much broader food and beverage business in Europe.

GF has been heavily dependent on coffee in Europe (61% of 1988 revenues) and has been seeking to achieve a broader food portfolio. Integration with Kraft fulfills this objective, plus achieves a significantly strengthened scale position in key countries, such as Germany and Italy.

Kraft's already strong positions in Germany and Italy are complemented by GF's businesses, plus GF offers scale to Kraft in the U.K., Spain, and Scandinavia. A challenge for both companies is how to penetrate the French food industry.

The most significant issues or opportunities we face are:

- to effectively integrate the GF and Kraft operations without losing focus on the business and yielding any advantage to competitors.
- to defend current businesses ferociously vs. competition, while keeping them relevant with consumers through a continued stream of new benefits.
- to profitably capitalize on the growth opportunities in Southern Europe (Italy, Spain, Greece, Portugal).
- to identify new core businesses that can provide longer term vitality.
- to achieve a larger presence in France.

GERMANY

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	3.5%	$477	$645	6.2%	$30	$49	10.2%
General Foods	3.7	445	574	5.2	23	32	6.9
KGF International		$922	$1,219	5.7%	$53	$81	8.8%

Germany is a large, prosperous market, but a very difficult operating environment where scale and strength of franchise is critical. The German trade is sophisticated, difficult, and powerful and complicated by the presence of Aldi, a major private label retailer. The major multinationals have significant scale (Nestle sales $2.9 billion, Unilever food $1.6 billion) plus local competitors, Oetker, Jacobs, are strong and committed. The consumer market is wealthy but very price conscious.

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Kraft

Kraft Germany (1988 Income/OP Revenue: 6.4%) leads its peers in profitability, but is nonetheless well below Kraft standards (1988 International average IFO % OP Rev 9.0%). Therefore the primary objective is to boost the IFO % OP Rev ratio to 7.6% by 1993.

We will continue to renew core categories, but believe the greatest gains may have already been realized. Therefore, we will need to increasingly move into new areas of the market at the expense of our competitors. Examples include the deli counter, which is a non-traditional distribution channel for us. Another is the health category where both Heinz (Weight Watchers) and Unilever (Du Darfst) have built sizeable positions.

One pressing issue is in the dinners category, where we have a 68% share and a brand name (Miracoli) synonymous with Italian cuisine. Prepared pasta sauces are posing a new threat with both Unilever and Mars trying to replicate the U.S. success of Ragu throughout Europe. In response, we will launch a jarred sauce in both Germany and Belgium.

Other strategic initiatives include line extensions to all major lines and a continued search for more innovative cost reductions (e.g., recent move to third party warehousing).

General Foods

The GF business is predominantly a coffee business which accounts for 82% of revenues and the balance being rice and beverage franchises. The HAG coffee business has a 5.6% share of the German R&G market with the HAG and Onko brands. While we are #5 in the total coffee market behind Jacobs, Tchibo, Aldi and Eduscho, HAG is #2 in the decaf coffee segment.

The German business has successfully completed a restructuring of overheads which has significantly improved HAG profits from $3.4MM in C'84 to $23.0MM in C'88 (IFO % OP Rev improving from 0.6% to 5.2%). The HAG coffee business is strategically important for our total coffee business in Europe and should be viewed in terms of its broader role as a sourcing unit and as a multi-country decaf brand.

The strategic focus is three fold: to build volume and share base in Germany through the relaunch of the Onko brand and the growth of HAG through line extensions, e.g. whole bean and espresso; to expand the HAG trademark broadly in Europe by entry into France, Spain, Scandinavia; to be a quality supplier of decaffeinated beans and freeze dried coffee for other GF units and private label customers.

GF in spite of its improved financial position, needs greater scale and leverage in the German market to be more competitive vs. larger and very tough competitors.

Summary

Germany presents opportunity for significant synergy between Kraft and General Foods in administrative overheads, selling and distribution, and in providing the additional scale leverage needed by both Kraft and GF vs. both competitors and the grocery trade. The scale of the combined companies should allow increased sales focus in the refrigerated and deli areas.

ITALY

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	3.2%	$580	$879	8.7%	$56	$100	12.2%
General Foods	3.8	224	341	8.7	25	37	8.4
KGF International		$804	$1,220	8.7%	$81	$137	11.1%

Italy is a market of significant growth opportunity. The consumer market is shifting from home preparations to commercial foods (mayonnaise, sauces) coupled with the growth of microwave ovens. The trade is very fragmented. Despite political volatility, well managed companies achieve attractive financial results and margins can be among the most attractive in Europe.

Kraft

Italy is our largest international unit and has led Kraft Europe in growth and profit. The growth has come from both expansion of the highly profitable base business as well as acquisition of two local companies, Invernizzi (88 sales: $257MM) and Osella ($36MM, 51% ownership).

Key actions programs include Kraft S.p.A. relaunch and line extension programs; rationalization programs in both Kraft S.p.A. and Invernizzi, plus building contacts with acquisition candidates.

Over the plan horizon, we will face three critical issues. Firstly, we must complete integration of the different companies. Until we do this, we will not be able to effectively transfer the marketing expertise resident in Kraft S.p.A. to the others. Nor will we be able to fully leverage our two distribution systems. Secondly, our S.p.A. franchises are under attack by MNC's moving into Italy. We will either have to fund these by milking our weaker franchises, e.g., margarine, or accept lower levels of profitability. Finally, we must try to complete acquisitions in a market with premiums inflated by "1992" fever. In particular, we must be prepared should Invernizzi's top competitor, Galbani (88 sales: $1.2B) become available. Were Invernizzi or the other competitor, Locatelli (Nestle), to acquire Galbani, the winner would then control over 80% of the volume through this important distribution channel.

General Foods

GF owns a 67% controlling interest in Simmenthal S.p.A., the leading Italian manufacturer of canned meats. Simmenthal is #1 in the canned sliced beef segment with a 75% share while our Mareblu canned tuna brand is #4 with a 11% share.

The plan calls for maintaining sliced beef market share and growing profitability in face of increasing price brand competition through increased focus on costs. A key program is to implement a reorganization of the sales force in order to increase effectiveness of in-store merchandising.

In the canned tuna business, we expect to grow our position to #2 through regionally focused marketing programs. We will also invest in a new tuna production process and canning line which will increase yields and reduce costs. The tuna business will become profitable and achieve a 5% income margin by C'93 on way to a target of 8-10%.

The major challenge is to increase profitability in face of rising raw material costs and price brand competition.

GF also owns 25% of Crippa e Berger...the exclusive licensee/distributor of Cafe Hag in Italy.

Summary

Synergies with Simmenthal will have to await purchase of our partner's 33% share. If this could be achieved, the Simmenthal products could be easily marketed through Kraft S.p.A.

Simmenthal would also bring a brand name that could be leveraged on meat products in the refrigerated distribution system.

UNITED KINGDOM

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	3.5%	$230	$372	10.1%	$25	$56	17.9%
General Foods	4.5	482	687	7.3	52	84	9.9
KGF International		$712	$1,059	8.3%	$77	$140	12.7%

The U.K. is a mature market with a highly concentrated trade and well defined competitive structures. While the consumer market is flat, important changes in consumer lifestyles and needs are creating segmented opportunities for extending established trademarks or creating new niche brands. With targeted marketing and tight cost management, good growth and returns should be achievable in the U.K. food industry.

Kraft

Our major competition in the U.K. is the trade. Its primary weapon is well supported, high quality private label. We must recognize that as soon as any category or subsegment reaches a respectable size, private label will enter and take up to 30% of the volume. Therefore, the most profitable U.K. food companies tend to be collections of niche positions.

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Since Kraft began its subsegmentation strategy in 1982, O.I. has grown at 28% (CAGR) per year even as volume declined by 26,300 MT. During this time the division shed almost 70,000 MT of margarine, bulk cheese and refined oils, and replaced it with around 30,000 MT of Philly Light, Vitalite, and Golden Churn. However, to be successful, this strategy requires a continual stream of small innovations and segmentations. Our pivotal issue in the U.K. is: Do we have a sustainable position? Are we sufficiently broad based should we exhaust the potential of one of our key categories? For example, what would happen if a major business like dairy spreads is eliminated due to regulation? We expect integration with GF's U.K. operation, which is twice the size and has presence in seven categories, will provide the solution.

The U.K. will continue to aggressively segment its categories (Cheddarie, Handi-Snacks, Cracker Barrel Slices, "Ultra" Margarine, Low Salt Vitalite, Golden Churn Light, Mr. Brains' Dinners), broaden the base using products from Europe (Miracoli, Miracle Whip) while coexisting with the trade (strategic PL participation). We will spend behind our categories aggressively to slow private label penetration and fund this spending through new productivity initiatives (salesforce rationalization, frozen foods plant streamlining).

General Foods

The U.K. company is GF's largest income business in Europe. While coffee is the core product category accounting for 72% of revenues, we also participate in a number of other categories including packaged desserts, ambient meals (in test market), vending and food service segments.

We have a strong #2 position in soluble coffee behind Nestle and are #1 in the small but rapidly growing R&G segment with the Kenco brand. Cafe HAG is the leader in the decaf segment. The plan calls for continued growth of the recently launched Kenco freeze dried and Cafe HAG brands and launch of further line extensions including Maxwell House decaf. Coffee away-from-home will be a key area of growth as a R&G, single cup delivery system is tested and expanded and the Maxpax vending system is expanded across Europe into Germany, Spain, Italy.

The dry packaged desserts market is expected to continue to decline and presents a major issue of how to make desserts a growth business for GF. The plan calls for line extending the leading Birds brand into the growing segments including microwave preparation. The business opportunity in the ambient ready-to-eat desserts segment which we entered with a range of Birds products is expected to be smaller due to unfavorable cost/quality versus chilled. We will assess the opportunity to enter the growing chilled dessert segment via Kraft refrigerated distribution.

The ready prepared meals market is expected to grow rapidly. We are currently testing a range of ambient shelf stable products under the Perfect Timing brand, which has met with great trade and consumer success. An expansion decision will made early in 1989. We shall use the Kraft brand name on the Perfect Timing range before any roll-out from test market.

Summary

Combining the Kraft and GF operation will increase total KGF leverage vs. the trade and offer synergies both in general overheads and new product opportunities, notably in the meals business near term. There would also appear to be benefits from increased food service scale.

SPAIN

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	12.0%	$ 90	$223	19.8%	$10	$27	22.9%
General Foods	7.8	125	187	8.3	(5)	6	+
KGF International		$215	$410	13.7%	$ 5	$33	48.3%

Spain is an area of significant opportunity. Consumer sophistication is growing, the trade is still fragmented, and entry into the EEC has enhanced both growth and stability. This will also result in increased competition as multinationals target Spain for growth investment.

Kraft

The Spanish company has done exceptionally well, managing to grow volume overall despite deliberately shedding 7,000 MT of fluid milk, and establishing excellent levels of profitability (1988: 11.0%, Income/OP Revenue). Income growth has come from both mix and margin improvement.

Future financial success will be driven by volume growth. To do this, we plan to grow the core (olive oil mayo, "milk story" for slices, increased support for cream cheese) and accelerate testing of products from other European divisions. We also need to develop products designed specifically for the Spanish market (manchego slices). The final route to growth will be increased acquisition. To support this, we will upgrade our management capabilities in this area. We believe our recent lease of the Riespri business may provide a model for future transactions involving family owned companies.

Over the course of the plan, Spain is expected to grow tonnage and revenues by 12% and 20% per year respectively. This is the second highest in Kraft International. As a result, we expect its relative profitability will drop. Currently, it leads Europe in IFO % OP Rev. While we expect the return on sales to grow over the period, we expect less improvement than in any other International division. This is consistent with our group strategy to invest in S. Europe.

General Foods

GF is the narrow leader in the growing R&G coffee segment with the Saimaza brand which has a 23% share. In the soluble segment, we are #2 behind Nestle. The Spanish coffee market is very competitive as multinationals, including Nestle and Douwe Egberts (Sara Lee) are investing aggressively to grow share. This is currently depressing industry profitability. We view Spain as a market in which we should be competing and believe that longer term it will result in an attractive business. Key strategies include the continued geographic expansion of the Saimaza coffee brand throughout Spain, plus extending both the Saimaza and Columba brand in the soluble coffee segment. HAG will be launched into the growing decaf segment in C'90 and we will enter the coffee vending segment with the Maxpax system.

The financial projection is to move into profitability in C'90 and grow margins over time as competitive shares stabilize.

The major issue we face is inadequate scale. In addition to growing the coffee business, we need to broaden the business base to further leverage our fixed costs and distribution system. We are now distributing biscuits for McVitie and are assessing possible add-on acquisitions that would be consistent with our current capabilities.

Summary

Both Kraft and GF will be advantaged by the combined scale in Spain and additional infrastructure this provides; however, additional growth and scale will be necessary to compete successfully in Spain and will require continued investment, plus add on acquisitions. It is not yet clear how much selling synergy there will be in Spain.

OTHER EUROPEAN MARKETS

GF has important positions in both France and Scandinavia where Kraft is currently not importantly represented and may offer opportunity to broaden the KGF portfolio.

FRANCE

GF's core business in France is the Hollywood gum and Krema candy businesses. Hollywood is a strong #1 in the gum category with a 89.0 share and Krema is #1 in bagged candy with a 24.0 share. The total confectionery business enjoys a 13% margin reflective of its leadership position.

The plan calls for growing the Hollywood gum business through extending into the rapidly growing sugarless gum segment and defending against the Wrigley introduction. The candy business has been successfully evolved from a low margin bagged candy business to an increasingly high value-added business through the introduction of new products including pocket candies where Krema is now the market leader. Plan calls for 8% annual volume growth driven by new flavor introductions and focus on the hypermarket channel. Hollywood gum is also sold in Belgium and Switzerland, and we are developing a broader European confectionery strategy.

We have not been able to develop a strong scale position in coffee given the strength of Jacobs and Douwe Egberts in France. We have a 16% share in the soluble segment, with the Maxwell brand behind Nestle with a 65% share. Our strategy is to continue to grow the Maxwell brand through segmented line extensions, e.g. flavored coffees. A number of other ideas including the launch of HAG decaf coffees and a range of youth positioned coffees, potentially in the liquid form are also being assessed. The GF France coffee sales force should provide a vehicle for testing Kraft items such as Miracoli dinners and other dry grocery items.

SWEDEN

GF's core business in Sweden is Gevalia R&G coffee which enjoys a strong leadership position with a 37% share. Within a relatively stable market, we have grown share from 33% in C'86 to 37% in C'88 driven by a shift from a direct to a wholesale distribution system which provides greater coverage. The plan calls for the growth of the recently launched Maxwell House premium R&G brand as well as the growth of Gevalia in the soluble segment and in coffee-away-from-home. In addition, expansion of Gevalia into other Nordic countries is underway with the entry into Norway in C'89.

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We also have a strong position (30% share) in the retail spice market with the Kockens line of products. We expect to achieve market leadership in C'89 with growth driven by increased distribution and the effectiveness of our sales force. The Kockens sales force should be able to effectively sell Kraft items now handled by a distributor in Sweden.

DENMARK

GF currently owns 40% of Scandinavisk Kaffe Kompagni AS, the leading R&G coffee company in Denmark with a 29% market share. We have a call option, which we intend to exercise in early C'91 to acquire the balance of the company.

ASIA/PACIFIC

	Volume Growth	Operating Revenue			Income		
				Avg Annual			Avg Annual
	C'88-C'93	C'88	C'93	Growth	C'88	C'93	Growth
Kraft	2.0%	$297	$447	8.5%	$42	$ 85	15.1%
General Foods (Reported)	10.1	36	64	12.0	11	23	16.2
KGF International		$333	$511	8.9%	$53	$108	15.3%
General Foods (100%)	10.1%	$926	$1525	10.5%	$56	$109	14.2%

Asia/Pacific is seen as a major growth opportunity for KGFI. The populations are large, the consumer society is just developing in many countries, and competitive structures are still evolving.

We have significant positions in the more developed countries of Australia and Japan. The most significant growth opportunities will be on the Asian continent, where we have experienced significant growth in Korea and expect strong growth in China.

The broad portfolios of both General Foods and Kraft should create significant opportunities for both direct investment, (generally joint ventures), as well as licensing and exports.

Asia/Pacific has been the major volume growth engine for GFI with volumes growing at an average 17% annually. The major driver of this growth has been the coffee business which accounts for 72% of revenues and has benefited from the take-off of coffee in Korea where we have a 49:51 joint venture with Dong Suh Foods. We also have a significant coffee business in Japan with a joint venture with Ajinomoto, Japan's leading food company, plus we have recently expanded coffee into China and Taiwan, also through joint ventures. The size of GF's total business in Asian (on a 100% basis) makes us the #3 food & beverage company in the region behind Nestle and Coca-Cola. We foresee continued strong growth for coffee as Asian countries shift from traditional tea cultures to coffee, plus we will broaden our focus beyond the retail market to include away-from-home coffee, particularly the vending market using the Maxpax system from Europe.

Our major challenge in coffee is ongoing broad competition with Nestle who has the leadership position in Japan, is about to enter Korea, and is paralleling our entry into China and Taiwan.

JAPAN

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
General Foods (Reported)	6.6%	$5	$10	14.4%	$10	$14	7.9%
General Foods (100%)	6.6%	$564	$799	7.2%	$25	$50	15.0%

General Foods

General Foods has had since 1974, a 50/50 joint venture (Ajinomoto General Foods) with Ajinomoto, a leading Japanese food company. AGF has about 1000 employees and two manufacturing plants and maintains 17 sales branches and product depots across Japan. The venture includes coffee, creamers, gift sets, and Gaines Pet Foods. Coffee is the core product category and accounts for 71% of total volume. We are #2 in soluble coffee with a 20% share behind Nestle with 72%, and, #3 in R&G coffee with a 12% share behind UCC and Nestle.

Our overall objective is to grow our coffee business by extending the key foundation brands (Maxim, Blendy) across all forms (soluble, R&G, whole bean) and enter high value-added segments. Maxim was relaunched in C'88 with a product which is superior to Nescafe Gold Blend. Initial results have been below plan as Nestle has defended aggressively using price promotion. Corrective actions are being taken which includes more competitive pricing and new advertising which strengthens the product quality communication. A Blendy product, superior to Nescafe will be launched in C'89. In the R&G segment, we plan to test sourcing product from the U.S. due to cost and yen/$ exchange advantages. We also expect to grow our coffee away-from-home business through the launch of coffee brewers and R&G single serve dispensers currently in development in the U.S. and Europe.

The key challenge near term is to achieve the franchise objectives of the Maxim relaunch. In addition major emphasis will be placed on reducing total overhead costs to get them more in line with the business size. This will result in structural changes and a move towards more off-shore sourcing.

Kraft

Kraft has a licensing business in cheese with Morinaga, a leading Japanese dairy company. Additionally, Kraft has been exploring other ways to grow the Kraft position in Japan.

KOREA

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
General Foods (Reported)	11.4%	-	-	-	$8	$13	11.8%
General Foods (100%)	11.4%	$300	$557	13.1%	$36	$54	8.6%

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General Foods

Dong Suh Foods is a joint venture with several Korean shareholders. Our equity has increased from 33% in 1968 to 49% currently. The company today has about 1,000 employees, four manufacturing plants and nine sales branches across Korea. Soluble coffee and coffee creamer are the core product categories where we have strong leadership positions with 96% and 90% share respectively. The other businesses are Post cereals where we are #1 and have a 65% share, canned liquid coffee, honey, tea, and dairy products. The business has grown dramatically due to growing soluble coffee consumption and government import and investment regulations which have restricted entry by foreign competitors.

Nestle formed a long expected joint venture with Doosan, a large Korean group, and will enter the market in mid C'89 with a range of soluble coffee and creamer products. Our key priority is to successfully defend against this and limit Nestle share gains. The defense plan includes two line extensions of Maxwell House soluble coffee, a new Maxim freeze dried line extension and increased media support. The distribution system will be further strengthened through the addition of two distribution centers. Product quality superiority will be maintained/achieved through application of aroma and flavor technologies. An aggressive capital program is planned to support these as well as increased capacity to deliver the planned volume growth of 12% per year.

The key near term challenge is to execute the defense against Nestle. The longer term issue is one of ensuring that the product portfolio can deliver sustained growth. DSF is assessing a number of product categories for entry, including additional dairy products.

Kraft

Development of the Kraft business is about to be initiated in Korea. A joint venture was to be formed with Lotte, a major Japanese/Korean firm. We shall attempt to shift this to a venture with GF's partner, Dong Suh Foods, who previously had acquired a dairy business and an oils business and is highly committed to leveraging the Kraft portfolio in Korea.

AUSTRALIA

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
Kraft	1.4%	$251	$353	7.1%	$32	$58	12.8%
General Foods	-	-	-	-	-	-	-

Kraft

The Kraft company possesses excellent franchises while operating in a small, relatively isolated geography. However, profitability is only average vs. both peers and other Kraft businesses.

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Australia must accomplish its objectives despite serious competitive threats in both food service and cheese. The situation in cheese is particularly difficult. Cheese is integral to the business, providing almost 60% of the gross profit. Our top three competitors are all coops that, despite low reported profitability, continue to attempt to buy share. One, NZDB, has been limited in its participation by an agreement which will disappear post-CER. In food service, we have traditionally realized very high margins as the sole source of some products, for example, portion control products. In the last year we have seen three new PC producers enter the market. Overall, competition in these two businesses is becoming more intense.

However, our retail grocery business is strong. This is due, in part, to aggressive share building advertising strategies. These are supported by excellent copy that dramatically visualizes points of difference.

We will continue to push the grocery business while trying to reverse the situations in cheese and food service. Any turnaround will be made more complicated by the jump in world dairy commodity prices, which has boosted the cash flow of the coops. We do not yet know whether they will be content to price to recover costs fully or choose this time to mount a new share offensive.

Australia also must overhaul its supply infrastructure to improve its cost position. First of all, we have too many unspecialized plants (15). Australia's tonnage per plant is around 10,000 MT/yr., about 60% of the International average. Canada's is over 100,000 MT/yr. We must rationalize this structure in order to concentrate investment and management attention. Because of geographical constraints, we still anticipate we will keep 6-8 plants. The system anchor will be an upgraded Pt. Melbourne, which will supply most of the grocery products.

General Foods

General Foods operations in Australia (coffee, cordials, jams, Tang) were divested in 1985 due to inadequate scale, weak competitive position in coffee, and poor earnings performance. The strong presence of Kraft now creates the opportunity to reassess the potential for leveraging the GF product portfolio in Australia.

PHILIPPINES

General Foods

GF has a 100% owned subsidiary which was established in 1974. The core product category is powdered beverages where Tang is the clear market leader. We launched regular Kool-Aid in C'87 which, after initial success, has been impacted by rapid increase in low price pre-sweetened competition. The plan calls for continued growth of the Tang business through flavor extensions and the introduction of pre-sweetened Kool-Aid to counter price brands.

We are also currently looking at the possible acquisition of the co-leader in the Philippines soluble coffee market. This would provide us a sound position in one of the largest coffee markets in Asia.

Kraft

Kraft has a 100% owned subsidiary and has the #1 or #2 positions with products in the jarred process cheese and the sandwich spread categories. Kraft's sales are about 50% greater than GF's and both use the same distributor.

In addition, GF is developing businesses in Peoples Republic of China and Taiwan via joint ventures.

TAIWAN

GF has a 50/50 joint venture with President Enterprises Corporation, Taiwan's leading food company, for the importation and sale of soluble coffee.

Soluble coffee is a rapidly growing category. Maxwell House is #2 in the soluble market with a 24% share, behind Nestle who has 50%. We are the leader in the gift set and coffee mix segments.

The plan calls for growing the Maxwell House business by increasing distribution to cover the important PX channel. In addition, increased focus will be placed behind the freeze dried form as consumers move to higher quality coffees. The strategy for entering the away-from-home segment is currently being developed.

PEOPLES REPUBLIC OF CHINA

GF currently has three joint ventures in the PRC which were established during C'85-C'88. These cover soluble coffee (Maxwell House), Tang and starch (to generate Forex). We are now entering the phase of expanding the production capacity at these small initial plants to meet the needs of the growing coffee and Tang markets.

Maxwell House has a 40% share of the small but growing soluble coffee market. We plan to grow this through improving quality and expanding distribution. The production capacity for Tang will be increased in C'89 to meet the exploding demand for this popular new product.

A key challenge is to continue to increase forex generation in order to meet our increasing requirements. We will focus on both manufacturing based export projects as well as counter trade opportunities. We will also source locally grown green coffee and packaging materials.

LATIN AMERICA/WORLD TRADE

	Volume Growth	Operating Revenue			Income		
	C'88-C'93	C'88	C'93	Avg Annual Growth	C'88	C'93	Avg Annual Growth
Kraft	4.8%	$163	$312	13.8%	$ 16	$ 35	17.3%
General Foods (Reported)	3.7	289	365	4.8	49	61	4.5
KGF International		$452	$677	8.4%	$ 65	$ 97	8.2%
General Foods (100%)	5.6%	$474	$789	10.7%	$ 47	$ 72	8.9%

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We have strong franchises in a number of countries but our overall stance towards Latin America is one of caution given the troubled economy in much of this region. Where appropriate, we are focusing our activities towards licensing and exports and are making direct investments only when justified by superior business propositions related to our core worldwide businesses or our strong national business.

General Foods

The role of GF Latin America/World Trade has been to develop GF beverage, confectionery and coffee franchises in high potential Latin American markets and in countries worldwide where GF currently has no equity investment. During C'83-C'87 earnings before tax have grown at a 15% rate and returns have been well above average. In C'88 earnings declined due to the impact of the hyper inflation in Brazil on our Brazilian beverage business and in Mexico due to prolonged price controls and high interest expense. The volatility of the business is reflective of the Latin American environments in which we operate.

Geographically, Brazil is the most important market accounting for 55% of total revenue followed by Mexico at 16%, Exports at 10%, and International Licensing/Trade, Middle East, Puerto Rico and Gevalia Imports at about 5% each. All of the non-licensee/non-export businesses are 100% GF owned except the Q-Refres-ko beverage and confection business in Brazil and the Sorvane ice cream business in Northeast Brazil in which we own a 45% and 50% interest respectively.

Cold beverages, ice cream and coffee are the key product categories. The beverage business consists of the Tang and Kool-Aid brands marketed broadly in Brazil, Mexico, Puerto Rico and the Middle East and enjoying strong #1 franchise positions in all countries. Kibon is the leading ice cream business in Brazil with a 70% market share and has demonstrated both strong volume and earnings growth attesting to the strength of this franchise, the high margins of its long novelty line, its distribution strength, its low level of working capital, and its high caliber management.

The plan forecasts continued strong growth for the Kibon, Middle East and the Gevalia import coffee business. Moderate growth is expected for Puerto Rico and the Export business. The plan calls for reversing the recent declines in the Q-Refres-ko and Mexico businesses based on specific growth programs for cold beverages. These also represent the major challenges in the plan.

An issue of scale in Mexico may be solved via combination with the Kraft business.

Kraft

Kraft's Latin America business is expected to rebound over the plan period led by improvements in Venezuela and our U.S. based Latin America Export operation. A return to normalcy by our Panama division will also contribute. These will help to compensate for the impacts of continuing declines in the Mexican economy. While macroeconomics explain most of the region's difficulties, it is true that we are not particularly advantaged in our competitive position in Mexico.

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In 1985, sales to Mid-East markets totalled over $100MM and profitability was $18.3MM, 10% of International's total. Today, sales are down by 38% and profitability has dropped to $5.5MM. The reasons for this are partially external, as the oil boom has tapered off and the Mid-East markets have matured. In particular, a 1987 tariff on imports coupled with currency fluctuations boosted prices to the Saudi consumer. This problem was compounded during the recent restructuring of our export operations into standalone market focused organizations.

Summary

The Latin America and World Trade businesses of Kraft and General Foods will be integrated with the prime synergies being in Mexico, where both companies need additional scale, and in the export and licensing functions where organizational efficiencies and new business opportunities should be achieved through integration.

We shall also explore synergies with Oscar Mayer in Venezuela, although Oscar Mayer has a joint venture partner there.

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KGF INTERNATIONAL
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INCOME STATEMENT

	1988	1989P	1990	1991	1992	1993
Volume	1,303	1,378	1,420	1,473	1,529	1,588
Net sales	$4,046	$4,400	$4,650	$5,082	$5,475	$5,901
Operating revenues	4,046	4,400	4,650	5,082	5,475	5,901
Var Cost of Product sold	2,136	2,368	2,452	2,677	2,878	3,103
Shipping expense	82	89	93	99	105	112
LIFO adjustment	0	0	0	0	0	0
Cost of sales	2,218	2,457	2,545	2,775	2,983	3,215
Marginal Contribution	1,828	1,943	2,105	2,307	2,493	2,686
Fixed manufacturing costs	298	314	341	363	384	408
Available profit	1,530	1,629	1,765	1,944	2,109	2,277
Marketing	959	989	1,090	1,191	1,294	1,397
General and Admin.	222	219	225	240	250	262
R & D	36	40	40	41	44	46
Curr. Trans./hedging costs	(1)	6	5	5	5	6
Other (inc)/exp	(20)	(11)	(10)	(8)	(7)	(7)
Total expense	1,195	1,243	1,350	1,470	1,586	1,704
Income from OPs., before Int., Goodwill & Assess.	336	385	414	474	523	573

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KRAFT GENERAL FOODS
GROUP: KGF INTERNATIONAL
MANAGEMENT INVESTMENT

($ MM)

	1988	1989P	1990	1991	1992	1993
NET RECEIVABLES	475	635	653	713	769	825
NET INVENTORIES	507	545	552	587	638	668
PREPAID EXPENSES	30	28	27	28	30	31
NOTES PAYABLES	84	102	186	217	225	228
A/P & ACCRUED LIABILITIES	645	659	680	738	792	847
WORKING CAPITAL	283	447	366	373	420	449
NET PROP, PLANT & EQUIP	637	725	742	771	826	889
INV & ADV TO UNCONS SUBS	139	163	184	184	204	226
TOTAL Y/E MANAGEMENT INVESTMENT	1,059	1,335	1,292	1,328	1,450	1,564

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GROUP: KGF INTERNATIONAL
CASH FLOW STATEMENT

($millions)

	1988	1989	1990	1991	1992	1993
Source/(Use) of Funds						
Income From Operations	$336	$386	$414	$474	$523	$573
Income Taxes	128	147	157	180	199	218
Net Income	208	239	257	294	324	355
Add: Net Corporate Assessments	0	0	0	0	0	0
Net Income Before Corporate Assessments	208	239	257	294	324	355
Amortization	0	0	0	0	0	0
Depreciation	50	68	78	91	103	116
Deferred Taxes	0	0	0	0	0	0
Change in Accounts Receivable	64	(160)	(18)	(60)	(56)	(56)
Change in Inventory	(43)	(38)	(7)	(35)	(51)	(30)
Change in A/P & Accrued Liabilities	25	14	21	58	54	55
Change in Income Taxes Payable	0	0	0	0	0	0
Other, net	66	36	19	23	(22)	(17)
Funds from Operations	370	160	350	371	352	424
Capital Expenditures	(128)	(180)	(127)	(135)	(154)	(171)
Other Invest & Acquis, net of Divest	(24)	(10)	(41)	(29)	(31)	(33)
Free Cash Flow	219	(30)	182	206	168	220
Long Term Debt Retired	0	0	0	0	0	0
Net Interest Expense(After Tax)						
Corporate Assessment(After Tax)						
Reduction of Untendered Kraft Stock						
Financing Provided	0	0	0	0	0	0
Change in Intercompany Account	$219	($30)	$182	$206	$168	$220

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